KEYNOTE SPEECH FOR PRIME FINANCE CONFERENCE ON 7 OCTOBER 2024 – "*THE ELUSIVE REPRESENTATION*"

1. On 13 September 1992 the Italian lira was devalued by 7%, closely followed by a 5% devaluation of the Spanish peseta and, on 16 September, the departure of the pound sterling from the European Exchange Rate Mechanism. That was 'Black Wednesday'. It was not a happy time for anyone who was long in so-called 'soft' currencies and short in 'hard' currencies such as the Deutsche Mark. It was unhappier still for anyone with a leveraged position of that kind. Black Wednesday was one of the financial crises that led to litigation about loss-making derivative transactions, based on alleged misrepresentations to the investor. The litigation illustrated some of the difficulties in getting home on such claims in financial product cases: difficulties which, in various guises, have continued to the present day.

2. One investor troubled by Black Wednesday was Denver Limited, an investment vehicle for a wealthy Middle Eastern family. It had bought some of Morgan Stanley's Principal Exchange Rate Linked Securities, or 'PERLS', and leveraged its position ten times using repurchase agreements or 'repos'. One type of PERLS, for example, had a redemption value which depended on the Italian lira and Spanish peseta holding their own against the Swiss franc and the Japanese yen. PERLS were a kind of contrarian bet that the softer currencies would not depreciate against the harder ones, or at least not so much as to erode significantly the high coupon.

3. Denver declined to pay on the next rollover of the repos, and alleged that the bank had made misrepresentations when the product was sold: broadly to the effect that it was safe and suitable for Denver's investment objectives. Efforts to settle before trial did not succeed, so the case was opened before Mr Justice Longmore in the Commercial Court. The late Gordon Pollock QC, counsel for Denver, did his best to add colour by loud *sotto voce* whispers of the phrase *"snake oil salesmen"* However, Denver's misrepresentation case had some problems. Notably, there was a tape recording of a call between Morgan Stanley's salesman, whose name was Simon, and Denver's representative, Mr

Khairy, a person of some financial experience. It included an exchange along the following lines:

> "Simon: OK, I just wanted to make sure you realise that this isn't an investment on which you couldn't lose money.
>
> Mr Khairy: (laughing) You've got me there, Simon, cancel everything!"

Mr Khairy proceeded to enter into the transaction on Denver's behalf. It is not difficult to see the problems that evidence could pose to a misrepresentation claim, and the case duly settled.

4. Another PERLS purchaser was Sr Alfio Puglisi, a wealthy dairy farmer and investor from Sicily who also declined to meet the losses incurred. The case came on in the Commercial Court with Iain Milligan QC again leading for Morgan Stanley, and before the same judge. Mr Justice Longmore observed during openings (in his inimitable tones) that *"Your client doesn't seem to having much luck with these investments, Mr Milligan"*. Sr Puglisi seems to have cut a somewhat sympathetic figure with the judge. Although he found Sr Puglisi to have been *"on occasions evasive, particularly on the subject of the size of his personal wealth"*, the judge was not persuaded that Puglisi intended to mislead at any stage in his evidence. He alluded to Puglisi's amazement about English disclosure process. In an earlier disclosure hearing, Longmore J had quoted Sr Puglisi's complaint that he had been turned inside out *"like an old sock"*. Sr Puglisi succeeded in fighting off Morgan Stanley's claim. His counsel, Barbara Dohman QC, managed to persuade the judge that the repo element made the transaction an off-exchange margined transaction prohibited by rule 980 of the Securities Association or TSA rules ([1998] CLC 481).

5. However, Sr. Puglisi did not succeed in his argument that the bank had impliedly represented the investment as being consistent with his objectives and without any unusual or risky features. Longmore J said *"Whatever may have been the position before the Financial Services Act, I cannot think there is now any scope for rescission for 'implied' representations."*

6. Those two cases illustrate the fairly simple problem of representations that cannot be proven on the evidence, or which the court is unwilling to imply. But more subtle difficulties can also arise. These often revolve around aspects of reliance or inducement.

7. *Bankers Trust v Dharmala* [1996] CLC 518 reached trial before *Puglisi* but arose out of later events: unexpected rises in US interest rates in 1994, to which two swap transactions were linked. Once again, representations of a qualitative nature were alleged. The judge, Mance J, accepted that a representation as to a matter of opinion, as opposed to fact, could be actionable if it implied (a) that the representor had knowledge or had made investigations to justify the opinion expressed, and/or (b) that there were facts which could reasonably justify the representor in forming the opinion expressed (p.530).

8. However, the judge found the alleged representations about the first swap not to be actionable because, among other things, the representees were too experienced and intelligent to have understood them to have the meaning alleged (p.550). He found that the bank's presentation about the second swap did create a risk that some recipients would accept it without qualification, and in that sense was misleading. However, Dharmala had no direct evidence that any misrepresented matters were fundamental to its decision, was by and large capable of evaluating and looking after its own position, and did so (p.573).

9. Sometimes there is a contractual hurdle to alleging reliance on a misrepresentation, because the parties have contracted on terms – often in the small print – which include agreement that no representations have been made or relied on. This factor came to the fore in a line of cases including *Peekay Intermark v Australia & New Zealand Banking Group* [2006] EWCA Civ 386 and *Springwell Navigation v JP Morgan Chase Bank* [2010] EWCA Civ 1221. In the latter case, the Court of Appeal, in addition to finding the alleged misrepresentations not to have been made, held that parties can agree that a certain state of affairs should form the basis of their transaction, whether it be the case or not, and that that agreement gives rise to an estoppel. Springwell was therefore bound by the statement in the terms of the investment (Notes linked to Russian Federation bonds) that no representation or warranty had been

made. Further, the court held that that provision was reasonable for the purposes of section 3 of the Unfair Contract Terms Act 1977.

10. There can accordingly be a so-called contractual estoppel precluding a misrepresentation claim. However, the focus of my talk today is, rather, the factual aspects of representation, reliance and inducement.

11. I therefore turn next to *Cassa di Risparmio della Repubblica di San Marino v Barclays Bank* [2011] EWCA Civ 484 (Comm). That case concerned investments in 'CDO squared' notes. The Notes had embedded within them credit derivatives known as collateralised debt obligations (or CDOs) which gave exposure to the credit risk of a pool of 'reference assets' through a portfolio credit default swap. Those reference assets themselves included further CDOs, each of which was in turn referenced to a pool of some 50 credit default swaps, hence the 'squared' description.

12. CRSM's case was that Barclays sold the Notes on the basis of their AAA credit rating, indicating a minimal level of risk, when Barclays knew and intended that the Notes were far riskier than their credit rating indicated. Whereas a AAA rating signified a default risk over 5 years close to zero, Barclays' internal 'expected loss' financial modelling indicated that, at their dates of issue, the CDO^2s had a probability of default over their lives of around 30% (equivalent to single 'B' or 'junk'). That was said be the case because there had been 'adverse selection' of reference assets, with the bank choosing (for its own benefit) assets skewed towards the highest risk end, as measured by their respective credit spreads, of their credit rating bands: a technique sometimes called 'credit ratings arbitrage'.

13. The judge, Hamblen J, did not accept CRSM's case on the nature of the investments. He accepted Barclays' evidence about the so-called 'credit spread puzzle', namely that implied probabilities of default, calculated from CDS credit spreads, are not regarded in the market as quantifying the real-life prospect of default: actual default rates are significantly lower than the credit spreads might imply. It followed from this, the judge thought, that "*the fact that the reference portfolios were largely populated by names paying higher-than-*

average spreads (for their ratings) similarly did not mean that the real world chances of default were different to those indicated by the ratings" (§ 307(2)). Whether that did follow, and whether it meant that the Notes were not more risky than their credit ratings implied, might be debated. However, my subject today is the question of reliance on the alleged representations.

14. It was literally true that the Notes were AAA rated. CRSM therefore needed to show that Barclays represented not merely that that was the Notes' credit rating, but that the Notes' risks were commensurate with such a rating; and that CRSM relied on that representation. However, the evidence ultimately given at trial did not support this. The judge said:

> "In cross examination Mr Montanari [of CRSM] confirmed that various points alleged to have been represented to him were simply matters of his own understanding, rather than matters actually stated to him by Mr Ferrario [of Barclays]. In particular, Mr Montanari stated that he understood that the AAA rating meant that there was a low risk of default, as far as he knew, and that this was not something that Mr Ferrario had ever told Mr Montanari; Mr Montanari said that Mr Ferrario "*only said there were some AAA notes, and in my mind they had a minimal risk of default*"; in re-examination, he was asked whether, when he had meetings with Mr Ferrario at which the ARLO notes were discussed, Mr Ferrario had said anything to him about the credit risk or risk of default of the ARLO notes and his answer was "*No, we never discussed it because AAA to us was synonymous of that tranquillo, safe and transparent that we were looking for.'*"" (§ 67; see also § 476(2) to similar effect)

15. Thus CRSM had <u>assumed</u> that the AAA rating indicated that the Notes carried a low risk of default. Further, had CRSM known the true position, then no doubt it would not have bought the Notes. However, that did not translate into a misrepresentation claim when (on the judge's findings) Barclays had not gone beyond a statement of the rating and, critically, CRSM had not understood Barclays to have gone beyond that bare statement of fact. On that footing, it could no longer succeed as a misrepresentation claim: the problem was with what Barclays had not said, rather than with what they did say or imply.

16. Essentially the same point has continued to recur. *Property Alliance Group Ltd v Royal Bank of Scotland* [2018] 1 WLR 3529 arose from the interest rate manipulation scandal. The claimant, PAG, entered into loan facility agreements

with RBS. These required PAG to enter into four interest rate swaps with RBS referenced to sterling LIBOR. Following the global financial crisis, LIBOR fell significantly and PAG became liable to pay interest rates under the swaps far greater than they received. The Financial Services Authority later found that RBS had manipulated Japanese yen and Swiss franc LIBOR. PAG sued the bank for misrepresentation among other things. Asplin J found that none of the five alleged implied representations had been made, nor in any event relied on. As to reliance, she said:

> "PAG did not rely on the alleged 'extremely complex and intricate' representations because they did not know about the BBA [British Bankers' Association] definition, how submissions were made or even that RBS was a panel bank, let alone that LIBOR was capable of manipulation; it was not enough that they assumed (although they did so assume) that LIBOR would be set in a straightforward and proper manner …." (§ 130(5))

and:-

> "It seems to me therefore, that there was no understanding of what are extremely complex and intricate pleaded representations meant and for the most part, the matters which were pleaded did not cross [the PAG representatives] Mr Russell and Mr Wyse's minds. On that basis, in my judgment, they could not have understood the implied representations to have been made and therefore, did not rely upon them. In the circumstances, it is not necessary to consider whether it is appropriate to ask what they would have done if told the alleged truth as against if nothing had been said. ... At best, it seems to me that both Mr Russell and Mr Wyse assumed that LIBOR, which they understood to be a commercial rate of interest, would be set in a straightforward and proper manner. In my judgment, therefore, they gave no thought to the LIBOR Representations in the form pleaded and did not rely upon them." (§ 419)

So Asplin J expressly differentiated between (i) reliance and (ii) the question of whether PAG would have acted differently had it known the truth: referred to in later cases as the 'counterfactual of truth'.

17. The Court of Appeal found that a different representation could be implied, to the effect that RBS was not itself manipulating and did not intend to manipulate sterling LIBOR. However, it upheld the judge's finding that any such

representation was not false (§ 157) and therefore did not need to consider the judge's finding about reliance (§ 159).

18. *Marme Inversiones 2007 v Natwest Markets plc* [2019] EWHC 366 (Comm) also arose from interest rate manipulation. Marme took a syndicated loan with an interest rate based on EURIBOR, and interest rate swaps with one of the lenders, NatWest Markets. In due course, Marme was unable to repay the loans and entered an insolvency process. The swaps were out of the money, and Marme sought to rescind them. It alleged that RBS had impliedly represented that it had not sought to manipulate EURIBOR and had no reason to believe that other banks were seeking to do so.

19. Picken J held that the alleged implied representations were not made; and, if made, were not relied on, largely because Marme was unaware of them. He cited the Victorian cases establishing that a claimant must show that he in fact understood the representation in the sense alleged, and relied on it on that basis (§ 282 citing *Arkwright v Newbold* (1881) 17 Ch D 301 and *Smith v Chadwick* (1884) 9 App. Cas 187). He also cited Christopher Clarke J's statement in *Raiffeisen Zentralbank Osterreich AG v RBS* [2010] EWHC 1392 (Comm) that it may not be sufficient for a representee to establish that he would have acted differently if he had known the truth: *"[i]f it were, a claimant who gave no thought to any representation, or did not understand it to have been made, might be entitled to recover"* (*Raiffeisen* § 187). Picken J quoted a passage from a non-financial instruments case, *Foster v Action Aviation Ltd* [2013] EWHC 2439 (Comm), in which the 'counterfactual of truth' approach was again rejected as a basis for showing reliance. Hamblen J there said:

> "… Unless one understands that a representation is being made it is difficult to see how it can be said to have been relied upon. <u>Mr Foster's evidence was that had he known at the time that the factory had financial issues he would not have signed the contract. However, the case is one of positive representation, not non-disclosure.</u> He gives no evidence that he understood that the Defendants were representing to him or telling him that the factory had no financial issues, still less that they were making the more specific representations set out in the pleading. I am accordingly not satisfied that inducement has been sufficiently proved." (Foster §§ 101, my emphasis)

20. Having reviewed the authorities, Picken J concluded that, whether a representation is express or implied, the representee must show that he/she had *"given some contemporaneous conscious thought to the fact that some representations were being impliedly made …"* (§ 286). Any other view would remove an important distinction between actionable non-disclosure and misrepresentation. Marne's representative accepted that it would not have occurred to him at the time of the transaction that any bank might put in a false quotation into the EURIBOR process; and that he would not have spent any time thinking about the process by which EURIBOR was set. So, at most, he merely assumed EURIBOR to be a 'true and honest' rate (§ 287). That was not enough.

21. Two years later came a third interest rigging case, *Leeds City Council v Barclays Bank* [2021] EWHC 363 (Comm). This was a strike-out/summary judgment application. The transactions were loans referenced to LIBOR, and the alleged representations were that LIBOR rates were (so far as the bank knew) being set honestly and properly, and that the bank was not (and had no intention of) engaging in any improper conduct in its participation in the LIBOR panel. The application proceeded on the assumed basis that the representations were made, were false, and were made fraudulently. The issue was reliance.

22. The bank's case was that the claimant must establish that it actively/consciously appreciated that the alleged representation was being made. The claimants could not show this, but said they did not need to. They said actual conscious thought was not necessary, at least in cases of representations by conduct. It merely had to be shown that the claimant was influenced by the representation: a question of fact in each case.

23. The claimants emphasised the House of Lords' decision in a criminal case, *DPP v Ray (a.k.a. Ray v Sempers)* [1974] AC 370. There, the defendant went to a restaurant with friends. He intended to pay, but changed his mind after eating and absconded. His conviction for dishonestly obtaining a pecuniary advantage by deception was upheld. The majority held that he had made a continuing representation, the effect of which was that he continued to be treated as an ordinary customer whose conduct did not cause suspicion; and *"[i]n*

consequence the waiter was off his guard and vanished into the kitchen" (p.383 per Lord MacDermott).

24. Lord Morris (another member of the majority) first addressed the representation made at the outset when the meal was ordered:

> "… when the respondent ordered his meal he impliedly made to the waiter the ordinary representation of the ordinary customer that it was his intention to pay. He induced the waiter to believe that that was his intention. Furthermore, on the facts as found it is clear that all concerned (the waiter, the respondent and his companions) proceeded on the basis that an ordinary customer would pay his bill before leaving. The waiter would not have accepted the order or served the meal had there not been the implied representation" (p.385-386)

25. As to change of mind, Lord Morris said: *"The waiter proceeded on the basis that the implied representation made to him (i.e. of an honest intention to pay) was effective. The waiter was caused to refrain from taking certain courses of action which but for the representation he would have taken."* (p.387). Similarly, Lord Pearson said the false continuation of the representation *"deceived the waiter, inducing him to go to the kitchen"* (p.391).

26. However, in *Ray* an implied representation had certainly been made at the outset, which could realistically be regarded as having actually influenced the waiter's mind. It is, I think, a conceptual leap to apply *Ray* to a case where the question is whether any representation has been understood and relied on in the first place.

27. Moreover, as Cockerill J pointed out in *Leeds*, the reasoning in *Ray* does not focus on the question of awareness of a representation as an element of reliance, still less dismiss it. It is true that, as Waksman J noted in *Crossley v Volkswagen* [2021] EWHC 3444, Lord Morris in the first passage quoted above noted that had the waiter known about the defendant's change of heart, he would have acted differently. However, Lord Morris made that point after having already found, two sentences earlier, that the defendant had in fact induced the waiter to believe that he intended to pay.

28. Finally, Cockerill J's decision in *Loreley Financing (Jersey) No. 30 v Credit Suisse* [2023] EWHC 2759 (Comm) arose from losses incurred in 2010, after the financial crisis, on CDOs referenced to sub-prime residential mortgage backed securities. The judge found the claims to be time-barred, and in the alternative that the alleged representations had not been made or relied on. As to reliance, Loreley submitted that if a defendant makes an implied representation intending the claimant to rely on it, then *"reliance may be established by the claimant showing that it would not have entered into the relevant transaction had it known the true position"* (§ 379(v)). Cockerill J rejected that approach, holding that, whilst there was no universally applicable test and the question is a nuanced one, the representee must in some sense be aware of the representation, whether or not that awareness can aptly be described as 'conscious thought' (§§ 385-397). As it was put in *Smith v Chadwick*, the representation *"must have produced in [the representee's] mind an erroneous belief, influencing his conduct"*.

29. It is difficult to argue with that as a minimum statement of the requirement. The problem with Loreley's approach was pithily expressed in a submission by Adam Sher cited in the judgment: "*the counterfactual of truth does not work as a gatekeeper because it does not distinguish between, on the one hand, mistaken assumptions not caused by the conduct and on the other, an understanding caused by the conduct or the representation*" (*Loreley* § 393).

30. Standing back, these problems about establishing reliance may be a symptom of an underlying problem in many claims arising from financial products. A product may have problematic features, like hidden risks or openness to manipulation. The nature of the investor or the product may be such that no regulatory remedy exists, and the seller may have assumed no duty to advise, hence the search for a misrepresentation. However, the seller may have made no express incorrect statement, leading the claimant to resort to implied representations or representations from conduct. Reliance on such representations is not difficult to infer in simple non-banking cases, like the restaurant customer in *Ray* or the auction bidder discussed in *Leeds* and *Loreley*. In complex cases, though, even if through legal ingenuity a representation can

be identified, in reality it may not have entered into the investor's thought processes. The real complaint may be that which the seller did not say, i.e. non-disclosure, which is normally non-actionable. Common law misrepresentation is unlikely to assist in such circumstances. Ultimately, the solution, at least in some risky product cases, may lie not in litigation but in avoiding the problem from arising in the first place: by having a better understanding of the product being bought, achieved by taking expert advice at the outset, whether from the seller (under an explicit advisory duty) or a duly qualified external adviser.

31. Thank you for listening to me.

Mr Justice Henshaw
7 October 2024