The 'Fraud is Not Enough' – English law raises the bar for proving reliance in misrepresentation claims

I. Introduction

What level of awareness is required to be in a person's mind when being induced by another to rely on an implied fraudulent representation? According to the English High Court, which recently had to answer this question in the context of a (successful) application brought by Barclays Bank plc ("**Barclays**") to strike out a LIBOR manipulation claim commenced against it by a group of UK local authorities (*Leeds City Council v Barclays Bank plc* [2021] EWHC 363 (Comm) (Cockerill J) ("***Leeds***")), an assumption in a person's mind that a representation is true is not sufficient to prove reliance on it. Instead, and by contrast, the misrepresentation has to be "*actively present*" in that person's mind for the reliance element of the misrepresentation claims to be made out.[1] That is notwithstanding that, on recent authority, a sub-conscious assumption by a representee can be sufficient for the representation to be implied in the first place.

The case raises two important issues. The first is the fundamental question of whether it is correct as a matter of legal principle to find that an actionable implied misrepresentation requires the claimant to have a level of awareness of the representation akin to actual knowledge. This is particularly so in light of the English Court of Appeal's relatively recent decision in another leading LIBOR manipulation case, *Property Alliance Group Ltd v The Royal Bank of Scotland Plc*,[2] where it was found (in summary) that implied representations by a bank as to the honesty and integrity of a financial benchmark which it participates in setting can be implied from the mere incorporation by the bank of the benchmark in a loan or swap product. The reason for this is that the counterparty to the loan or swap is entitled to assume that the benchmark is honest and reliable and that the bank has not been involved in manipulating it. Second, and no less importantly for those involved in litigation before the English Courts, which have traditionally been reluctant (especially in novel or developing areas of the law) to grant strike out applications in cases where additional facts and evidence relevant to the determination may be expected to emerge by the time of any trial, there is the procedural question of whether it was appropriate for the Court to determine the awareness issue on a strike out application ahead of the main trial.

It may be for these (as well as for other) reasons that leave to appeal from the High Court's decision was granted in *Leeds*, meaning that the English Court of Appeal recently heard an appeal on 22 February 2022. Indeed, a subsequent High Court decision in late 2021 distanced itself from the Court's reasoning in *Leeds*, and noted the upcoming appeal. This may suggest that the Court of Appeal will closely examine the correctness of the new awareness requirement laid down by *Leeds*.

II. Context: LOBOs and the LIBOR scandal

Leeds is the latest in what is now a long line of cases which have come before the English courts as a result of the LIBOR scandal, which first broke into public consciousness as long ago as 2012.

1 *Leeds* at [102].
2 [2018] EWCA Civ 355 ("***PAG***").

As is well known, LIBOR is an acronym for the London Interbank Offered Rate, a set of benchmark rates whose purpose is to reflect the cost of inter-bank borrowing on the London financial market. While, as a result of the scandal, extensive efforts are now being undertaken by regulators and market participants to transition financial contracts away from LIBOR, LIBOR remains the most widely used interest rate benchmark in the world, referenced in some USD 373 trillion notional value of financial transactions of all types. In simple terms, it is supposed to reflect the rate at which a prime bank could obtain an unsecured loan from another bank in a particular currency for a particular period in the London market.

In the period from 2006–2008, when the loans at issue in *Leeds* were entered into, LIBOR was calculated by surveying a panel of major banks every day for their assessment of the rates at which they considered they would be offered funds for specific currencies and maturities. In 2012, the LIBOR scandal erupted. It was discovered that a number of panel banks were manipulating LIBOR for various currencies. This manipulation took a number of different forms, but for example, rather than submit their genuine assessment of the rate at which they thought they would be offered funds, it was often the case that panel banks would submit rates that assisted their trading divisions to profit from LIBOR-linked derivatives trades, or which were lower than they should have been, with a view to projecting creditworthiness. The scandal led to fines, prosecutions and extensive reforms on both sides of the Atlantic and beyond.

The LIBOR-based financial instruments at issue in *Leeds* were so-called Lender-Option Borrower-Option loans ("**LOBO loans**"). In essence, these are long-term loans that enabled the lending bank (here, Barclays) to change the interest rate in line with fluctuations in market rates. However, if the lender did so, the borrower had the option to pay out the outstanding amount in full, thereby avoiding the need to pay any higher interest rate. These loans have proved to be unsuitable for local authorities, and have given rise to very high (and above market) debt servicing costs. All of the LOBO loans had the common feature that LIBOR was used to set either the interest rate or certain breakage costs.

III. The alleged representations

In essence, the claimants argued that by offering the LOBO loans to the councils, Barclays had impliedly represented that the LIBOR rates were being set honestly and reliably, and that Barclays was not (and had no intention of) engaging in any improper conduct in connection with its role in setting LIBOR rates. The alleged implied representations (on the claimants' case) were that, as at the date of the loans, Barclays *had not itself* previously attempted to manipulate the LIBOR rate; *was not* currently doing so; and *had no intention* to do so in the future. Further, Barclays (on the claimants' case) also impliedly represented that it had no reason to believe LIBOR *had been*, *was being* or *would be* manipulated by other banks

IV. The claims

The claimant councils argued that Barclays had made fraudulent misrepresentations in connection with its participation in setting the LIBOR rates during the 2006 to 2008 period. Accordingly, their claim was for rescission of the LOBO loans, in an attempt to claim restitution of the sums paid thereunder and, commercially, to refinance their borrowing at lower and more affordable market rates. There was an alternative claim for damages on the grounds of negligent (i.e. non-fraudulent) misrepresentation. Given it was a strike out application, the Court was required to take the claimants' case at its highest, and assume

the relevant pleaded facts were true. As such, the Court proceeded on the basis that the alleged representations were made, that each was false and Barclays made those false representations fraudulently.

We note that there was a further alternative issue about whether the claimants had sufficient knowledge such that it could be said that, in any event, they had affirmed the LOBO loans. A finding to that effect would have led the claimants to fail in their fraudulent misrepresentation claims. We do not consider this aspect of the decision in detail, save to note that, as a matter which was inherently factual in nature, the Court found against Barclays on this point – on the basis that the point could not fairly be resolved on a strike out application.

V. The Court's decision

The Commercial Court found that the pleaded facts did not satisfy the test in law for reliance in an action for misrepresentation. As noted above, the conclusion was that, for the reliance element of the misrepresentation claim to be proved, a representee must be aware of a representation in the sense of it being "*actively present to his mind*".[3] He or she must have turned his mind to the representation, and an assumption – here, that LIBOR was being set honestly and reliably by Barclays – was not enough. This decision was said to be justified by reference to the misrepresentation authorities generally, and also specifically by reference to the rate-manipulation implied misrepresentation cases (chiefly *PAG* and *Marme Inversiones 2007 v Natwest Markets plc* [2019] EWHC 366 (Comm) ("***Marme***")). The Court went on to find that, because the claimants had not pleaded that any of the alleged misrepresentations consciously operated on anyone's mind, the claims were bound to fail (at [157]). Accordingly, the claims were struck out before reaching the main trial.

(1) First issue – whether knowledge requirement is correct

As a preliminary point, the *Leeds* decision affects both fraudulent misrepresentation claims (i.e. claims seeking rescission, as the claimants did in *Leeds*) and tort claims for misrepresentation, including the tort of deceit. While fraudulent misrepresentation and deceit claims are very similar in nature, they are distinct causes of action and should be pleaded separately.[4] Notwithstanding, deceit cases are often cited in fraudulent misrepresentation cases and vice versa: both contain the element of reliance necessary to complete the cause of action. Accordingly, the outcome of the *Leeds* appeal is important generally to claims involving civil fraud.

With that consideration in mind, the primary issue raised by the *Leeds* decision is whether it is correct as a matter of legal principle. To reiterate, the Court found that an active awareness or "*active presence*" of the representation in the mind of the claimant is an essential element in a misrepresentation claim (see [102] and [151]). In short, the person must have turned his or her mind to what was being represented. A mere assumption of the relevant state of affairs is not enough.

This point was characterised by Barclays as an issue going to the reliance element of the fraudulent misrepresentation claim at issue. Barclays' defence (and the Court's decision) was that the councils had not relied on any representations made by Barclays because the relevant employees of the councils did not, at

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3 *Leeds* at [102].

4 *Derry v Peek* (1889) 14 App. Cas. 337 at 359, per Lord Herschell.

the time they were made, actively or consciously appreciate that the representations were being made to them. In accepting this submission, which had also previously been accepted (albeit *obiter*) by Mr Justice Picken in *Marme*, the Court placed weight on the distinction between a claim for misrepresentation (which is actionable in the general sense), and a claim for non-disclosure (which is only actionable if there exists a duty of utmost good faith, or where it is specifically contracted for).[5] The Court also explicitly sanctioned an approach of breaking down the 'inducement' element of misrepresentation into its "*building blocks*" – essentially, in appropriate cases, looking at the individual smaller parts of that element.[6]

As a matter of principle – and in the event that it were to stand – the Court's decision has cut down the scope of implied misrepresentation under English law significantly. This is because, according to the Court, implied misrepresentation claims in effect require a level of awareness akin to actual knowledge. Mrs Justice Cockerill emphasised that the precise level of knowledge may be formulated in different ways: "*when that requirement is in issue, in some cases the question will be what the claimant consciously thought, but in other cases it may be better expressed by a focus on active presence*".[7] Nonetheless, this case sets the bar higher for claimants when faced with an otherwise actionable implied fraudulent misrepresentation.

This finding does not sit well with the reasoning of the Court of Appeal in *PAG*. While in that case the Court of Appeal ultimately found in relation to the LIBOR claims at issue that it could not interfere with the trial judge's findings of fact that the Royal Bank of Scotland ("**RBS**") had not in fact manipulated the relevant GBP rates to which the claimant's swaps were tied (the only regulatory findings of manipulation as against RBS related to the setting of rates in Japanese Yen), it nonetheless made the following finding: "*[a] party to a contract containing a swap needs to be certain of the counterparty's honesty at the beginning of the deal not just in the future but throughout its course*".[8] Indeed, it went on to find that, on the facts, the RBS had impliedly represented it was not manipulating LIBOR (and did not intend to do so). Moreover, the Court of Appeal found that this "*comparatively elementary representation would probably be inferred from a mere proposal of the swap transaction*…".[9]

That representation about honesty may operate consciously or sub-consciously on a person's mind. Indeed, as argued by the claimants in *Leeds*, Barclays' position (and the Court's decision) effectively invites a "*rouge's charter*".[10] This is because, in order to prove reliance on such a representation, the representee would need to ask themselves 'is the representor making an implied representation to me, and if so, what are its terms?'. However, as recognised by the Court of Appeal in *PAG*, some representations are so intrinsic to a proposed transaction that they do 'go without saying' (see, *contra*, Mrs Justice Cockerill at [152]). Representations as to the honesty of the counterparty and the integrity of an interest rate benchmark plainly fall into such a category. Accordingly, it is not obvious why a claimant's assumption that the counterparty has made the representation should not also be sufficient to prove reliance upon it, especially in circumstances where the claimant would not otherwise have entered into the relevant transaction had he or she known the truth. By holding to the contrary, *Leeds* significantly restricts the extent to which

5 *Leeds* at [95].
6 *Leeds* at [145].
7 *Leeds* at [146].
8 *PAG* at [125].
9 *PAG* at [133], emphasis added.
10 *Leeds* at [40].

implied representations may practically operate in a commercial context, as a claimant would always need to actively turn his or her mind to all of the possible representations that may be made in a given scenario.

This leads to a linked criticism of the Court's reasoning. The Court did not give sufficient weight to presumption of inducement – namely, that in cases of fraud, there is a presumption that the fraudster induced the claimant to rely on the representation. This is due to the very fact a fraud is being perpetrated. In this regard, both *Leeds* and *Marme* have led to the 'parsing' of the constituent elements of fraudulent misrepresentation to an unacceptable degree. This is a result of the Commercial Court's recent approach in this line of cases, in which it unpicks the "*building blocks*" of the elements of the tort (see *Leeds* at [145]), thereby losing sight of the broader point at stake in these rate-manipulation cases – namely, that "*fraud unravels everything*". That famous *dictum* of Lord Denning in *Lazarus Estates Ltd v Beasley*[11] has recently been re-emphasised by the Supreme Court in *Takhar v Gracefield*.[12]

As noted above, a recent case—*Crossley v Volkswagen Aktiengesellschaft & Others*[13]—distanced itself from *Leeds* and came to the opposite conclusion on the putative 'awareness' requirement, also on a strike out application. This high-profile case concerns the 'dieselgate' scandal, whereby it is alleged that Volkswagen used 'defeat devices' to manipulate emissions tests set by regulators. Part of that case is a claim for fraudulent misrepresentation, essentially alleging that by the sale of vehicles, the relevant manufacturers represented that those vehicles complied with applicable regulatory standards; that testing had been honestly carried out to meet those standards; and that they did not incorporate devices preventing the accurate recording of emissions. VW applied to strike out that aspect of the claim, among others.

The Court considered, for the most part, the same case law as *Leeds*, and yet found that there was a "*real prospect of success*"[14] for the deceit claim in *VW*, and declined to strike out that claim. In essence, this was because Mr Justice Waksman considered that in cases of implied misrepresentations, there "*are real questions arising from what is to be drawn from the fact that an implied representation from conduct is established which means that the reasonable representee would assume or infer the content of the representation from the conduct observed.*"[15] In other words, if it is enough for a representation to be implied from conduct in the first place, why cannot a reasonable person at the same time <u>also</u> assume or infer something from the very fact it has been made? The representee is effectively 'saying something by doing something'.

The only real distinction to be drawn between *Leeds* and *VW* is that the former concerned misrepresentations made in the context of entry into LIBOR-related banking transactions, and the latter did not. The Court in *Leeds* placed heavy emphasis on this factual similarity, in particular that the representations in question were alleged to be "*effectively identical*" to those alleged in *PAG*, meaning that *Leeds* could not be decided in a vacuum.[16] Although the Court in *VW* took account of this factual distinction, it did not think the underlying point of legal principle on reliance was *"a "short point of law" which [it] should grapple with"* on a strike out application, and ultimately came to the opposite conclusion to *Leeds*.[17]

<u>(2) Second issue – determination of the point on a strike out</u>

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11 [1956] 1 QB 702.

12 [2019] UKSC 13 (see Lord Kerr's speech at [43]–[53]).

13 [2021] EWHC 3444 ("***VW***").

14 *VW* at [97].

15 *VW* at [97].

16 *Leeds* at [147].

17 *VW* at [97].

In *Leeds*, given it was a strike out application, it was, as the Court acknowledged, for Barclays to persuade it that the case should not proceed to trial. Nonetheless, the Court found that because the claimants' pleadings could not *in law* satisfy the test for implied misrepresentation, the case should be struck out. Two key points may be made.

First, while the Court had the benefit of argument on the awareness issue, more weight should have been given to the point that here the Court was required to take the claimants' case at its highest, and assume the fraudulent misrepresentations had been falsely made (due to the fact it was a strike out application). The Court itself recognised that, were it not for the *PAG* and *Marme* decisions, it would be a "*short step*" towards finding that the issues on awareness were not suitable for summary determination ([149]). However, as the Court of Appeal recognised in *PAG*, its decision on the law of implied fraudulent misrepresentation was not the last word. The law in this area is still developing. Therefore, in accordance with well-established practice before the English Courts, it was not appropriate for the issue raised by Barclays to have been determined summarily. That "*short step*" should have been taken.

Second, and more importantly, the Court found that there are some cases of misrepresentation where the element of awareness may come "*very close*" to an assumption, and careful analysis is required to make the relevant distinction.[18] This is the crux of the issue, but the Court's reasoning on it in *Leeds* was thin. This point was squarely picked up by *VW*. In referencing a case not cited to the Court in *Leeds*, Mr Justice Waksman explained that there, a landlord had concealed from a purchaser the existence of dry-rot in a flat. The purchaser would not have bought the flat had he known of the dry-rot. Rather powerfully, the Court in *VW* reasoned: "*while the claimant could readily say that had he known of the dry rot etc. he would not have purchased, it is hard to see how he could have been "consciously aware" of the representation as distinct from making an assumption*."[19] In other words, the line between awareness and assumption vanishes. Should that distinction collapse, then, arguably, so does the new awareness requirement.

For this reason, as well as in light of the significant impact that the decision will have on civil fraud claims in England if the decision is allowed to stand, the outcome of the appeal in February 2022 is eagerly awaited. As the High Court in *VW* recently noted, there remain "*particular issues raised where implied representations by conduct are alleged…which have yet to be fully worked out*".[20]

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Following the events of the coronavirus pandemic and subsequent economic recovery, the English courts are experiencing an increase in the number of civil fraud cases, as frauds perpetrated before or during the market stresses are subsequently exposed. As shown in this Client Alert, counterparties and investors who consider they may have been the victim of a fraud may have legitimate misrepresentation claims available to them.

If you have any questions about the issues addressed in this Client Alert, or would like to explore the validity of and/or scope for claims in relation to suspected fraudulent conduct, please do not hesitate to reach out to us.

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18 *Leeds* at [147].

19 *VW* at [77].

20 *VW* at [97].

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