Scope of lending bank's duty to commercial borrower to treat the customer fairly (Morley v RBS)

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Restructuring & Insolvency analysis: The court dismissed a commercial property developer's claim for damages against the Royal Bank of Scotland (RBS), the claims having been brought in tort and contract. The judgment raises substantial questions for borrowers and lenders as to the circumstances in which a breach of term to exercise reasonable skill and care may arise, and the parameters of the torts of intimidation and duress. Hugh Sims QC and John Virgo, barristers at Guildhall Chambers in Bristol and counsel for the claimant, discuss the case.

Morley v Royal Bank of Scotland [2020] EWHC 88 (Ch), [2020] All ER (D) 116 (Jan)

What are the practical implications of this case?

The judgment in *Morley v RBS* examines:

- the scope of a lending bank's duty to a commercial borrower to treat the customer fairly, particularly in the context of the exercise of its enforcement powers available under the security given by the borrower
- the ambit of the tort of intimidation and economic duress

The case will be of particular interest to borrowers who have been transferred by high street banks into so called 'business support', or restructuring departments, including RBS' Global Restructuring Group (GRG), as well as those advising such borrowers and lenders. It also considers the 'interplay' between RBS' interest as lender and as a potential buyer, via its subsidiary company, West Register, and its approach to securing repayment of borrowing under objectives directed by the Asset Protection Agency (APA), following measures taken by the government to strengthen the perceived solvency of (in particular) RBS. The APA offered a level of insurance to RBS in respect of defaulting loans.

What was the background?

In December 2006, RBS, keen to win back Mr Morley's business, offered a non-recourse loan of £75m, secured over a substantial property portfolio in the North West of England. The loan was for three years and required Mr Morley to enter into a hedging contract with RBS' capital markets, which proved to be onerous and unsuitable. RBS agreed to the facility being 'non-recourse' with interest at 1% over the bank's base rate.

With the fall in interest rates in late 2008 and early 2009, the commercial arm of the bank found it was losing money on the lending and Mr Morley was unable to access low borrowing costs without paying a large break cost to terminate the hedging instrument. After a series of unsuccessful attempts to persuade Mr Morley to vary the terms of the facility and rebase it to LIBOR, in January 2009 RBS commissioned a desk-top re-valuation of the portfolio on which it relied to show that he was in serious breach of a loan to value covenant.

In due course the account was referred to GRG, which, Mr Morley claimed, had no real interest in restructuring but rather in the portfolio being acquired by the bank's subsidiary, West Register, with a view to medium to long-term profit. Mr Morley made an offer to buy back the portfolio for a sum in excess of the market value attributed to it by the bank's valuer, which was initially of interest to RBS, but appeared to conflict with the APA's wish to see the portfolio transferred to West Register, which had positive implications for any liability to insure RBS against defaulting loan losses.

RBS's initial apparent objective was for the portfolio to be 'surrendered' to West Register. Although attracted by Mr Morley's offer to buy back the portfolio, Mr Morley complained that the bank was inhibited from proceeding with his offer(s), or making fair counterproposals, because of the APA's preference that the portfolio be 'bought' by West Register.

After a series of refinance offers that were unattractive to Mr Morley, in July 2010, the bank told him that if he would not agree to transfer the portfolio to West Register, then it would (via LPA receivers) transfer it to West Register, without exposing it to the open market, and potentially at a price equivalent to the debt.

As a result, Mr Morley claimed he entered into an agreement whereby he retained a small part of his portfolio but surrendered the lion's share of it to RBS—or more particularly, its nominee, West Register.

Against the above background, Mr Morley complained that:

- in offering a restructuring service, RBS owed a duty of care to exercise reasonable skill and care in assessing suitable steps to take and that they had failed to do so
- in 'forcing' him to 'surrender' most of the portfolio, the bank had unlawfully 'intimidated' him and failed to fulfil its restructuring obligations

It was Mr Morley's case that the threat was an act of unlawful duress in that it entailed in substance a disposal by a mortgagee to itself (as there was no real distinction between RBS and West Register), and in the alternative lawful act economic duress was relied on.

What did the court decide?

The court agreed that RBS was providing banking services, including in relation to its restructuring conduct and proposals, and that these should be provided with reasonable care—that did not necessarily extend, however, to implementing the bank's internal instructions set out in the GRG Manual as to how to restructure businesses, because that was not necessarily a reasonable standard to apply. Once the loan was in default due to a breach of the LTV covenant and a fortiori once it had expired, there was no duty to offer restructuring services and the bank's right to obtain repayment of the loan prevailed. The court did however conclude that it appeared there was no material operational difference between RBS and West Register so that in any conventional sense a transfer of Mr Morley's portfolio to West Register might well be an unlawful transfer to itself—the threat to do which was unlawful. On the facts of this case, however, the threatened disposal to West Register was a matter about which, at least arguably, Mr Morley could not complain as, in the light of the non-recourse nature of the loan, and the down valuation of the portfolio, he could have no interest in the equity of redemption. The court could not be satisfied therefore that in the unusual circumstances of this case the threat was unlawful. Further, although satisfied that a threat was made in the terms alleged, the court concluded that, not being satisfied it was unlawful, Mr Morley could only rely on it as an example of 'lawful act duress', to establish which he would need to show that it had been made in bad faith. Although the maker of the threat knew that RBS had no right to demand that the portfolio be surrendered to West Register, that did not equate to bad faith.

The reasoning on both limbs of the case may be said to raise substantial questions for borrowers and lenders as to:

- the circumstances in which a breach of term to exercise reasonable skill and care may arise, and
- the parameters of the torts of intimidation and duress

The implications are that if a customer was forced to surrender security for a loan to the bank's nominee, where there was some equity or a realistic hope of a surplus being returned to the borrower, then on the facts of this case such a transaction may be open to challenge as procured by duress and/or intimidation.

Case details

- Court: High Court (Chancery Division)
- Judge: The Hon Mr Justice Kerr
- Date of judgment: 27 January 2020

Hugh Sims QC is ranked in Chambers UK as a leading barrister across seven practice areas including Insolvency. He is instructed nationwide, both as sole leading counsel and with juniors, in complex and substantial company and personal insolvency disputes, including claims for and against insolvency practitioners. He was appointed as a deputy High Court judge in 2019.

John Virgo is a specialist commercial barrister, with a strong practice emphasis on high-value financial product mis-selling litigation. He has appeared in nearly all the leading mis-selling cases and has also acted in a number of leading cases concerned with the manipulation of LIBOR. John is instructed nationwide in complex and substantial disputes. He is also retained offshore in Isle of Man and Jersey. He has authored, co-authored and contributed to numerous financial publications, including the Compliance Officers' Handbook (LexisNexis).

In Morley v RBS, Hugh and John were counsel for the claimant.

Interviewed by Kate Beaumont.

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