Neutral Citation Number: [2017] EWHC 834 (Ch)

Case No: HC-2016-002639

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

Royal Courts of Justice
Rolls Building, 7 Rolls Buildings
Fetter Lane, London EC4A 1NL

Date: 12/04/2017

Before :

MR JUSTICE MANN

- -

Between :

(1) BARNETT-WADDINGTON TRUSTEES (1980) LIMITED
(2) DAVID SULLIVAN
(3) CHRISTOPHER WARD **Claimants**

- and -

THE ROYAL BANK OF SCOTLAND PLC **Defendant**

- -
- -

Mr Mark Warwick QC and **Ms Justina Stewart** (instructed by **Kaye Tesler & Co**) for the **Claimants**
Mr John Taylor QCand **Ms Laura John** (instructed by **Addleshaw Goddard LLP**) for the **Defendant**

Hearing dates: 29 – 30 March 2017

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Judgment Approved

Mr Justice Mann:

Introduction

1. These proceedings are the second set of proceedings about a secured loan given to the claimants by the defendant bank ("RBS" or "the bank"). The disputes were and are about the entitlement of the bank to add the costs of unwinding an interest rate swap to the amounts required to redeem the loan early. The swaps in question are not agreements with the claimant; they are swaps which the bank says it entered into to hedge the risk of the fixed rate loan which it provided to the claimants. In the first set of proceedings ([2015] EWHC 2435 (Ch)) Warren J held that the unwinding costs of the swap transaction then before him (which was an internal bank swap) could not be added to the redemption cost. The bank, having now discovered what it says is an external back to back swap (i.e. with an external counterparty), has asserted that it would be entitled to add the costs of unwinding that swap to the redemption charges. In these proceedings, the claimants say that the bank can no longer make that claim

because it is *res judicata* (as they describe the point) in the sense that it ought to have been raised and dealt with in the first proceedings but was not. The bank says that its costs of breaking the swap would exceed £4.7m. The loan was a little over £9m. Those two figures demonstrate the significance of this dispute.

2. The form of these proceedings is a claim form in which the claimants seek a declaration that they are not obliged to pay the second set of swap costs and an order that on payment of the sums due under the loan agreement (without the swap costs) they are entitled to redeem the charged property. They have brought a summary judgment application on the footing that the defendant has no real prospect of defending the claim, and there are no underlying disputes which depend on disputed factual evidence or which need a trial. For its part the bank has issued a cross-application for summary judgment on the basis that the claimants' case is unsustainable.

3. At the hearing before me Mr Mark Warwick QC led for the claimants; Mr John Taylor QC led for the bank. Mr Warwick also appeared before Warren J in his hearing; the bank on that occasion was represented by Mr Taylor's junior, Ms Laura John.

The contractual background to the dispute

4. The relevant factual contractual background appears in Warren J's judgment and it is unnecessary to repeat most of it here. The following short narrative will suffice for the purposes of this case and these applications.

5. On 1st April 2004 the claimants borrowed over £9.2m from the defendant bank in order to purchase a development property at Wildwood Way, Worcester. The term of the loan was 30 years and the interest was essentially a fixed rate of 6.24%. The loan agreement permits early redemption but on terms, one of which involves an indemnity against certain losses. The contractual side of the dispute in this case arises out of one of the indemnity clauses, namely clause 12.1(f). It reads:

> "12.1 Indemnity
>
> The Borrowers shall indemnify the Bank on demand against any Loss (including any Loss on account of funds borrowed, contracted for or utilised to fund any amount payable under this Agreement, any amount repaid or prepaid under this Agreement or any Advance and any loss of Margin) which the Bank has sustained or incurred as a consequence of:

.....

> (f) any cost to the Bank incurred in the unwinding of funding transactions undertaken in connection with the Facility, including *inter alia* costs incurred when there has been a reduction in the market level of interest rate underlying the Loan. Such costs will be equivalent to the loss of interest income to the Bank as a result of re-deploying funds at a lower interest rate than that which prevailed when the Facility was made available, such costs to be determined by the Bank in their sole discretion."

6. Other terms of the loan agreement are set out or referred to in the judgment of Warren J, and I do not need to set them out here. The loan was a limited recourse loan in that the bank's rights of recovery were limited to the security and there was no right of recovery against the debtors personally, but nothing turns on that.

7. The issues which have arisen in this case turn on the words in clause 12.1(f) "funding transactions undertaken in connection with the Facility". The main question in the first case was whether they were apt to refer to an internal swap (operating between two bank departments) effected by the bank, so as to give the bank an indemnity under it in the event of early redemption. That is the question which Warren J determined against the bank.

8. The internal swap was referred to in correspondence and evidence leading up to the first dispute, but the swap documentation was not produced until some way into the hearing before Warren J. It was said by the bank to be a back to back swap in the sense that it was intended to match the transaction with the claimant and turn a fixed rate return into a floating rate return. The documentation takes the form of an internal letter dated 1st April 2004 addressed by the Financial Markets division of the bank to the Glasgow office of the bank. The Glasgow branch was the fixed rate payer - the rate was 6.240625%, which is effectively the same rate as the loan rate. The Financial Markets division was the floating rate payer. The notional principal was £9,237,500, reducing quarterly to just over £3.8m over 30 years.

9. The bank has (since the hearing before Warren J) discovered an external interest rate swap agreement with an external counterparty which it says was a back to back swap related to this loan and seeks to say that unwinding it before the end of the loan period would be a "cost incurred to the Bank in the unwinding of funding transactions undertaken in connection with the Facility". It is essentially that assertion which has led to the present proceedings, in which its assertion is challenged by the claimants. The swap's effective date is 1st April 2004. The bank is the fixed rate payer at a fixed rate of 4.9175% (rather less than the fixed rate on the loan); the notional amount is £10m (more than the fixed rate on the loan); and the termination date is 1st April 2034. The claimants do not accept that this is a back to back swap which would fall within the provisions of 12.1(f), but the applications before me proceeded on the assumption, for the purposes of the applications, that it was capable of being a "funding transaction undertaken in connection with the Facility", and the claimants say that if that were the case the bank would still not be entitled to rely on it.

The events leading up to the first proceedings

10. These events are an important part of the background to the present proceedings, because it is necessary to understand them in order to understand what issues were raised in those proceedings, and, critically, why and by whom they were raised. Unfortunately this requires the recitation of quite a lot of correspondence and (in due course) a lot of the material relevant to the trial in the first proceedings.

11. In 2014 solicitors Kaye Tesler & Co ("Kaye Tesler") acting for the claimants (described in the correspondence as Merchant Place Property Syndicate 35, or MP35) entered into correspondence with the bank about figures that the bank had given for redemption, and in particular figures relating to an interest-rate swap which it seems the claimants and their solicitors did not understand. It is apparent that in the initial stages the claimant and Kaye Tesler thought that the bank might be asserting that there was some sort of interest-rate swap financial product which the claimants had entered into. The correspondence then developed into an attempt by the claimants to understand what the bank was saying, and the bank seeking to make itself understood in terms of what it was alleging it could claim. This correspondence forms a central part of the background to the main question in this case because it is said to go to a formulation of the issues which were eventually decided by Warren J. The precise terms of some of the correspondence are vested with great significance. In those circumstances it is necessary to set out a significant amount of that correspondence.

12. On 25th February 2014 Kaye Tesler (Mr Kaye) wrote to RBS (Legal Department), apparently on the false assumption that his clients were somehow involved in a swap transaction. He said (so far as relevant to this case):

> "What our clients are seeking to ascertain is what steps did the bank take to ascertain the person with whom they entered into a loan agreement had the right to enter into that loan agreement so as to bind our client. If it can be established that the bank acted correctly in dealing with that person then the next question is whether the bank complied with all appropriate rules on selling a swap with that person. These are reasonable requests. If the loan agreement was mis-sold then the bank will appreciate that the loss to our client is in the region of two million pounds.
>
> …
>
> As we have stated in previous correspondence we have sent such documents as we have to counsel to advise whether the

> totality of our correspondence meets the criteria of the pre-action protocol leading to the pre-action disclosure."

13. It was apparently thought that there was a question-mark as to the circumstances in which the claimants entered into a swap agreement. It took several months for this point to be resolved. On 7th May 2014 Mr Kaye wrote:

> "We refer to our previous correspondence and especially your letter of 14th April in which you state inter alia, '…Merchant Place Property Syndicate 35 (Syndicate) was never sold an interest rate hedging product.'
>
> You complain that we make different requests at different times. You will see that the prime area that we have been looking for is the question of disclosure… You have stated on more than one occasion that no interest rate hedging affects this case, yet our clients have received an email from Kathryn Fergusson who describes herself as an "Associate Director, RBS Global Restructuring Group," and she writes that as at 13th November last year the loan value was £8,734,941 and Swap MtM is £2,500,000. The bank cannot have it both ways.
>
> …
>
> Please clarify the exact position and, having regard to Kathryn Fergusson's email please provide current redemption figures. Kindly note that we are asking for those figures as part of our investigation as to the situation. We do not have any instructions concerning redemption."

14. The bank responded to this (and another) letter on 27th May 2014:

> "You mention that the Bank has previously stated that no interest rate hedging affects this case. This is not accurate. The Bank has maintained the position, and still does, that the Merchant Place Property Syndicate was not sold an interest rate hedging product and that this was not a condition of the finance.

> The position is that on 1 April 2004 Merchant Place Syndicate 35 entered into a Loan Agreement with the Bank. We note that your client was advised at the time on [sic] the entry into this Loan Agreement by Jason Lewis of Howard Kennedy.
>
> In order for the Bank to provide this loan at a fixed (rather than floating) rate of interest, the Bank itself had to enter into an interest-rate swap in connection with the facility in order to fund the transaction and hedge the risk of changing interest rates.
>
> As set out in the Loan Agreement, your client remains liable and agreed to indemnify the Bank for any loss incurred if this funding transaction has to be unwound i.e. break costs for terminating this swap early to match any earlier repayment of the loan itself.
>
> It is for this reason that your client has, on a number of occasions, been provided with figures from RBS employees in respect of both the principal loan balance (plus interest) and the prevailing Market-to-Market or MtM on the swap.
>
> You have received redemption figures for your client's debt exposure to RBS. We set out some indicative figures below:
>
> | | |
> |---|---|
> | Outstanding principal on the loan - | £8,671,962.93 |
> | Accrued interest on the loan - | £53,243.48 |
> | Interest-rate swap termination costs (MtM) (as at 14.02) - | £2,396,276.25 |
> | | £11,122,446.77 |
>
> Please note that these are indicative figures at as 21 May 2014 only and are subject to change. Due to continuing market fluctuations in interest rates, the MtM amount will change (potentially both up or down) and updated figures will need to be re-issued immediately ahead of any proposed redemption."

15. Thus the bank was trying firmly to set out what the actual position was and to disabuse the claimants of their perception that somehow there was an allegation that they themselves had entered into an interest-rate swap transaction. A letter from Mr Kaye of 28th May 2014 indicates that the position was slowly being understood but he pressed for some pre-action disclosure so that his client could understand what had happened. That was met by a long letter from the bank dated 10th June 2014 in which the bank went back over the history of the matter. It starts by referring to some sort of complaint made in March 2013 in relation to "an interest rate hedging product

(IRHP)" and sets out the history of some of the correspondence. At paragraph 8 of that letter it sets out the bank's position:

> "8. Secondly, it appears that you misunderstand and mischaracterise the position in relation to a possible 'swap' or IRHP under the Loan Agreement:
>
> a) We can confirm that the Syndicate does not have an IRHP/interest-rate swap agreement with the Bank. The Loan Agreement is a fixed rate loan. As previously explained, in order for the Bank to be able to provide the loan on a fixed (as opposed to floating) rate basis, the Bank itself entered into an interest-rate swap in connection with the facility in order to fund the transaction and hedge the risk of changing interest rates.
>
> b) The interest-rate swap termination cost referred to in our letter dated 27 May 2014 is recoverable from the Syndicate members as borrowers under (Clause 12.1 of) the Loan Agreement pursuant to which, as was set out in that letter, the Syndicate members agreed to indemnify us for any loss incurred as a result of the funding transaction being unwound early.
>
> 9. It appears that you are probing for an angle through which your client may seek to challenge his liabilities for losses under the indemnity in Clause 12.1 of the Loan Agreement. However, you fail to take into account the real and fundamental distinction between a scenario where your client has entered into an IRHP (which is not the case here), and your client being liable, as borrower under the Loan Agreement, to indemnify the Bank for losses in accordance with the provisions of that document."

16. The bank then went on to resist what it regarded as a pointless and unsubstantiated request for documents and further information.

17. Mr Kaye responded on 13th June 2014 indicating that the bank's clarification of the situation had been helpful. However, he still sought further information:

> "As you say in your letter, we do have a copy of the Loan Agreement and you specifically refer us to paragraph 12.1 which is headed Indemnity. An indemnity is a provision to compensate for loss as is clear in the balance of the clause. Please identify, in this instance, the loss that was incurred and the circumstances thereof, by reason of which the bank has claimed under the indemnity."

18. The bank responded to that request on 24th June 2014:

> "Secondly, you ask for confirmation of the loss that the Bank has suffered and for the Bank to identify the circumstances for the loss. As regards the latter point, you will appreciate from my previous letter that the circumstances in which loss would arise would be on early repayment of the loan following sale of the property and the Bank's internal interest-rate swap being unwound as a consequence. We should note that this is not the case at this stage and, therefore, no interest-rate termination costs exist at present. Your client has, however, been informed of the anticipated termination cost (by way of an indicative redemption figure) in anticipation of a possible early termination of the loan."

19. On 27th June 2014 Mr Kaye wrote again to the RBS legal/litigation department complaining about what he described as a change of tack and what was said to be non-compliance with some FCA rules. Nothing turns on the terms of that letter. The bank responded to it on the 8th July 2014 saying:

> "We have already explained the position to you. As stated in our letter of 10 June and previously, there is no interest-rate swap between the Syndicate and the Bank. The Bank entered into a separate, internal swap in relation to the funding of the fixed rate loan to the Syndicate. The interest-rate swap termination costs referred to in our letter dated 17 May 2014 is recoverable from the Syndicate members as borrowers under (Clause 12.1 of) the Loan Agreement pursuant to which, as we set out in that letter, the Syndicate members agreed to indemnify us for any loss incurred as a result of the funding transaction being unwound early."

The letter ends by observing that the preceding letter from Mr Kaye takes matters no further. It also points out that Mr Kaye had made no attempt to articulate any basis for a claim at any point in the course of the correspondence and had not attempted to comply with the Practice Direction on pre-action conduct. The observation that a claim had not been articulated was in my view correct.

20. On 9th July 2014 the bank wrote again, responding to a previous request for information from Kaye Tesler saying the following:

> "1. If the loan continues to maturity and it is then repaid in full, there will be no liability to pay in respect of the internal swap arrangement as this is due to mature on the same date.
>
> 2. Your client's cost to date relate to the loan (in particular the payment of interest) and, as stated previously, the Bank was able to offer this to you client at a fixed rate because of the

> internal swap arrangement being in place. However, your client had so far incurred no additional costs in respect of this."

The continued reference to the internal swap arrangement should be noted.

21. On 3rd September 2014 Kaye Tesler wrote further about the investigations they were conducting relating to the "swap arrangement connected to our client's loan". They went on:

> "A problem from the very outset has been the lack of documentation that has been retained by our client. Matters remain unresolved and we continue to look into various aspects. One of the points that we are looking at is a point based upon the principles of contract law. You are aware that the bank repeatedly denied that there was a swap arrangement. On being pressed the bank revealed that a swap arrangement did exist but it was not one with our client but with another party. On being pressed the bank then revealed that the other party was in fact the bank itself wearing a different hat. It remains unclear whether the bank arranged a separate swap in relation to the specific loans in this case or simply bundled it in with many other similar cases.
>
> When asked under what provision of the Loan Agreement our client could be made liable for the cost of breaking the swap we were referred to Clause 12 of the Loan Agreement, which indemnifies the bank against any loss. The question that we have put to leading counsel is whether our client could be held liable under paragraph 12 for a loss which our client had no opportunity for foreseeing. We believe that counsel will shortly be returning from its summer break so we anticipate a response and his opinion in the not too distant future. You may care however in the interim to explain how our client could be held liable for a loss based on an arrangement of which she had no notice.
>
> Returning to the point made at the beginning of this matter, our initial approach to this situation is governed by the fact that our client does not have all of the appropriate documentation. That documentation has been requested from you but, not surprisingly, the bank has, to all intents and purposes refused…"

The letter then goes on to request some fairly extensive information, invoking the Data Protection Act 1998.

22. That request for information was followed up by a letter dated 11th September which said:

> "We refer to our previous correspondence and confirm that we have been considering your letters, particularly those dated 27th May 2014 and 9th July 2014. We note that you apparently claim, under the guise of Clause 12.1(f) hidden and potentially unlimited charges in respect of an interest-rate swap. In order that consideration can be given to the validity of the Bank's potential claim we call upon you to answer the following questions:
>
> A) Please identify each and every funding transaction that the Bank allegedly undertook in connection with the loan facility provided in April 2004, saying in respect of each allegation:
>
> 1. Whether it was entered into orally or in writing.
>
> 2. [Particulars of any oral conversation and any note thereof]
>
> 3. If it was in writing identify each material document and provide a copy of the same.
>
> B) In respect of each transaction:
>
> 4. The cost the Bank has allegedly incurred in the 'unwinding' of the transaction or would incur if it was wound [sic] now.
>
> 5. Exactly how that cost is calculated."

23. Before the bank could answer those questions, Kaye Tesler wrote a further letter on 17th September:

> "We refer to our previous correspondence and, apart from the regulatory issues you are aware that our client's position is that he denies that in the event of our client redeeming the loan to the Bank before full term that the Bank has the right to consider the cost of it undoing its internal swap as a loss and claiming that loss from our client pursuant to paragraph 12 of the loan. This is a relatively straightforward point. Our client claims that the Bank is unable to claim such loss as nothing in relation to that potential loss was ever made clear either to our client or to anyone representing our client."

24. The Bank responded to those two letters in a letter of 2nd October 2014:

> "In response to your questions:
>
> A) Your request for "each and every funding transaction that the Bank allegedly undertook in connection with the loan facility provided in April 2004" is not understood. We have already provided you with redemption figures should the Syndicate wish to redeem the loan before its maturity, setting out the Syndicate's debt exposure to RBS which includes the cost of terminating the interest-rate swap early.

> B) As you know, the Bank has not incurred any cost in unwinding its interest-rate swap arrangement as it has not been unwound. If the loan continues to maturity and it is then repaid in full, there will be no liability to pay in respect of the interest rate swap arrangement as this is due to mature on the same date.
>
> In terms of the cost of terminating the interest-rate swap early, this is calculated on a mark-to-market costs basis…"

25. The letter went on to decline any pre-action disclosure. Although the bank does not in this letter identify the relevant interest-rate swap as being the internal swap, it is obvious from the terms of the letter, in the context of the preceding correspondence, that that is what the bank is referring to. It is not clear to me why the bank had any difficulty in understanding the question about "each and every funding transaction" and why it could not simply refer to the internal swap arrangement as being the only relevant matter, unless the bank was being deliberately cagey about that and wishing to leave open the possibility that there were other potential funding transactions (which I doubt). In any event, the tenor of the answer given at paragraph A) of the bank's letter, against the previous correspondence which is referred to, is such as to confirm that the internal interest-rate swap is effectively the only funding transaction that the bank did undertake. If the bank had had anything else in mind then the letter would have been deliberately misleading.

26. On 7th October 2014 Kaye Tesler responded expressing surprise at the bank's response to paragraph A), setting out the basis of its questions and also repeating them. It referred to the loan and the relevant words of paragraph 12.1(f) before repeating the questions and ending:

> "You will appreciate that RBS is contending that, if our client redeems its loan now, it will be liable to pay a sum of nearly £2.4 million in addition to the principal and interest relating to the loan. Our client is entitled to the information it has requested. If this information is not forthcoming it will have to begin proceedings to obtain it."

27. The bank's response came in a letter of 20th October. It said:

> "We set out the position below in respect of points A) and B) in your letter dated 11 September 2014.
>
> A) You ask for information in respect of 'each and every funding transaction that the Bank allegedly undertook in connection with the loan facility provided in April 2004'.
>
> We told you in our letter dated 2 October that we had already provided you with redemption figures should the Syndicate wish to redeem the loan before its maturity. Those figures set out the Syndicate's debt exposure to RBS, which includes the cost of terminating the interest-rate swap early.

> Given this, it is implicit that there are no other funding transactions aside from the interest-rate swap set out in the redemption figures.
>
> Your response in your letter dated 7 October 2014 is to point out that the Bank has included the cost of terminating the interest-rate swap early in its redemption figures.
>
> We consider we have responded to your query: there are no other funding transactions in connection with the Syndicate's loan facility, aside from the internal interest-rate swap which has been the subject on [sic] ongoing correspondence."

The letter went on to confirm that "the transaction that would need to be unwound should the loan be redeemed early is the interest-rate swap" and to confirm that the bank had not hitherto incurred any costs in unwinding the interest-rate swap. The categorical statements as to the absence of other funding transactions should be noted, because it explains how the issues came to be formulated as they were in the first proceedings.

28. Before moving on in the chronology it will be useful to determine certain things which arise out of that sequence of correspondence:

a) The correspondence started with a misconception on the part of the claimants as to how they might be liable for swap transaction costs. They were probably a little slow on the uptake when the bank provided an explanation, but in the end that explanation was given and, to a degree, understood.

b) By the end of the correspondence the bank was proposing one, and one only, candidate for a "funding transaction" for the purposes of Clause 12.1(f). That was its internal swap. There was no way that the claimants could know, without being told by the bank, what transactions the bank might be relying upon as funding transactions. When the bank said it was relying on the internal swap, then the claimants were justified in understanding that that was the only transaction relied on and thereafter to focus on that. In his submissions Mr Taylor sought to say that when stating in its letter of 20th October that there were "no other funding transactions aside from the interest-rate swap set out in the redemption figures", the bank was saying that there were no other funding transactions in relation to the specific sum of £2.3 million-odd referred to in its 27th May letter. I reject that submission. It is a misreading of the correspondence. It is quite plain that when the bank said what it said in its letter of 20th October about the absence of other funding transactions (which it said twice) it was referring to funding transactions for the purposes of Clause 12.1(f).

c) Since the claimants would have no knowledge of what were

> said to be funding transactions, they were entitled to rely on what the bank said in the correspondence in considering and formulating the next steps which they wished to take. This is important in considering how it was that the first action came to be formulated in the way that it was.

The first proceedings - statements of case, evidence and submissions

29. Matters moved from that stage in the correspondence to the commencement of the first proceedings. Under cover of a letter dated 10th November 2014 Kaye Tesler sent to the bank a copy of the proceedings in draft, which comprised a draft Part 8 claim form and a draft witness statement of Mr Kaye. Those drafts were in the same form as their final form. Their content is important, and it will be useful to set out some of that content here because it is necessary to understand the response of solicitors for RBS when they were served with the documents.

30. The claim form reads as follows:

> "The Claimants are the principal borrowers and the Defendant is the lender pursuant to a loan agreement made on 1st April 2004 ("the Agreement") relating to a term loan facility of £9,237,500.
>
> The Claimants claim:
>
> 1. An inquiry as to what is due to the Defendants pursuant to the Agreement.
>
> 2. An inquiry as to whether the Borrowers (pursuant to the Agreement) are liable to pay to the Defendant, what it calls in its letter of 27 May 2014, an "Interest Rate Swap termination cost", and (if such a liability arises) how, when and why it arises and how the alleged cost is to be calculated.
>
> 3. Further or other relief.
>
> 4. Costs."

31. The claim form was supported by a witness statement of Mr Kaye, which sets out his capacity and goes on:

> "3. In circumstances more fully described below, for several months I have been in correspondence with the Defendant in an endeavour to discover the amount payable to the Defendant in order for the Facility to be redeemed. The Defendant maintains that, in addition to the outstanding principal and interest, it is entitled to (what it calls) an "Interest Rate Swap termination cost" (see its letter of 27th May 2014). The amount claimed in respect of this cost is said to be well over £2 million.
>
> 4. The Claimants inform me that they never agreed to take out any "Interest Rate Swap" with the Defendant. In correspondence the Defendant has admitted that the borrowers were "not sold an interest rate hedging product and that this was not a condition of the finance"
>
> ….
>
> 5. I have continued to correspond with the Defendant, asking very specific questions, yet the Defendant has failed to disclose the legal basis for its claim. Since the Claimants, via myself, have exhausted their dialogue with the Defendant this claim is brought in order to oblige the Defendant to justify its claim, if it can. If the claim cannot be justified then the Defendant must abandon it, and allow the borrowers the opportunity of redeeming the Facility without having to pay an unwarranted and very large extra cost."

32. Mr Kaye then sets out a number of the terms of the Agreement and moves on to set out quite a lot of the correspondence. He includes extracts from the correspondence in which the bank quite clearly indicates that it was relying on the unwind costs of the internal swap and clause 12.1(f) but for some reason Mr Kaye suggests that the bank had not answered the two questions ((A) and (B)) that he posed at the end of the chain of correspondence. I do not know why he professed to having such difficulty in understanding what the bank was saying, but that is what he professed in his witness statement. His witness statement ends by averring that the bank had not answered his questions and that the bank has therefore not justified its contention that the borrowers were somehow liable for the cost of the internal interest-rate swap.

33. Receiving the draft claim form and witness statement induced the bank to engage external solicitors, and Addleshaw Goddard replied to Kaye Tesler on 13th November 2014. Their letter pointed out what it said were defects in the Part 8 claim form, on the basis that the claim form did not seek the determination of a question by the court. It pointed out that the claim form sought an "inquiry" as to whether or not the claimants were liable to pay the interest-rate swap termination cost without putting

forward any basis upon which they should not be held liable. The letter stated that the bank had explained the basis of the claimants' contingent liability and had sought to answer the questions. They purported to struggle to identify what question the court was actually being asked.

34. That letter was followed by another letter from Addleshaw Goddard of 17th November 2014, enclosing a spreadsheet which sought to explain "the costs of funding the fixed rate provided to your client under the loan". The continued reliance on the fixed rate swap should be noted.

35. The claim form in the first proceedings, in the same form as the draft referred to above, was issued on the 14th November 2014, and Mr Kaye's signed witness statement, with exhibits, followed. The bank's response was a witness statement of Mr Michael Barnett, a partner in its solicitors Addleshaw Goddard, signed on 2nd December 2014. He records that the claimants said that the bank had failed to answer some questions and that it was the bank's contention that the claimants had failed to put forward any coherent basis for its claim or the remedy sought. He sought to make good that suggestion in what followed. Having set out the background to the loan, under the heading "Funding the Loan", he stated as follows in his paragraph 13:

> "13. As is common with fixed rate loans (particularly long-term fixed rate loans), the Bank itself entered into an interest-rate swap to fund the interest on the Loan and to hedge the risk the Bank faced on the possible fluctuation in interest rates in providing the (fixed rate) Loan (Internal Swap). The Internal Swap is between RBS Corporate Banking Division and RBS Markets, the interest rates desk which is responsible for hedging all of the Bank's interest rate risk (including the Bank's risk in funding the Loan) with market counterparties on a portfolio basis."

36. This is an important paragraph. It refers to one swap, and one swap only – namely the internal interest-rate swap. It also seems clearly to indicate that any hedging in the external market is done on a portfolio basis; that is to say it was not done on a back to back basis in which one transaction would be clearly matched by a matching swap intended to relate to it. In my view that paragraph reinforced the impression as to the ground on which the bank was standing in claiming break costs as part of the price of redemption – it was the interest-rate swap, and only the interest-rate swap, that was being relied on. That confirms what was said in correspondence, though the "portfolio" point was new.

37. Mr Barnett then goes on to refer to the correspondence, including correspondence in which the bank answered Kaye Tesler's question about all the funding transactions that the bank had undertaken in connection with the Loan.

38. In his section entitled "Evidence in support of the Claim", Mr Barnett refers in paragraph 36 to what he says was the bank repeatedly pointing out to the claimants the relevant clause of the loan agreement entitling it to be indemnified in the event of the loan being "unwound early". At paragraph 41 he turns again to answer the questions posed by Kaye Tesler's letter of 7th October and he says:

> "(a) **Identify each and every funding transaction that the Bank allegedly undertook in connection with the Loan**
>
> (i) The Bank responded on 20 October (exhibited at page 91-92 of MFB1) explaining that there were no other funding transactions made in connection with the Loan other than the Internal Swap that had been the subject of previous correspondence between the parties."

He then goes on to answer the question "What cost the Bank has or would incur on the unwinding of the Internal Swap?" and explains that the bank had already explained that the costs of terminating that swap earlier were calculated on a mark-to-market basis.

39. The significant effect of that witness statement for the purposes of the applications before me is that Mr Barnett has continued the theme of the bank's reliance on the internal swap, and that he stated clearly, for the purposes of the proceedings, that the only "funding transaction" that the bank had entered into was that internal swap. There is, in my view, no equivocation in what he is saying. Mr Taylor sought to suggest that somehow that was explicable on the footing that it all related back to the original £2.3 million in the 27th May letter so it was understandable that he would be focussing on the internal swap and nothing else. I do not accept any such qualification to what Mr Barnett was saying. It is quite clear what the bank's case was – the internal swap was the one and only thing that was said to be a "funding transaction". It was implicit that there could be no external swap which was a candidate because hedging into the external market was done on a portfolio basis.

40. That witness statement from Mr Barnett provoked two things. The first was a further witness statement from Mr Kaye and the second was an application to amend the claim form.

41. Mr Kaye's further witness statement was dated 5th January 2015. In it he indicated (in order to resist a suggestion made by Mr Barnett) that he did not accept that it was for the claimants to explain the legal basis for why they were not liable to the defendant, but nonetheless made the statement in order to provide an outline of the claimants' case. He put forward arguments for saying that there was no liability on a proper construction of the loan agreement because it could not have been in the parties' contemplation, on an objective basis, that the claimants should be liable for the termination costs of a hedging product of which they had not been informed. He went on to address further arguments as to why a funding transaction could not refer to "an associated hedging transaction that the bank has chosen to undertake alongside a funding transaction." The bank's internal arrangement (about which he observed it had provided no documentation) did not satisfy the language of clause 12.1(f). Then he said that the defendant would have to show evidence that it would suffer "Loss" and had not done so, before adding an argument that the bank's claim was void for uncertainty. He ended by saying:

> "30. The Claimants wish the court to rule upon the claim made by Mr Barnett at paragraph 13 of his statement. The Claimants contend that they are not liable to pay the Defendant any sum in respect of the "*Internal Swap*" described therein. I contend that such a declaration can be made within the scope of the existing Part 8 claim. However, to remove any doubt that the court can consider this point, the Claimants invite the court to amend the claim in accordance with the draft amended claim form that has been provided."

42. The proposed amendment was to add an additional paragraph 3 to the claim form:

> "3. A declaration that the Borrowers are not liable to pay the Defendant any sum in respect of the "Internal Swap" as described at paragraph 13 of the Witness Statement of Michael Felix Barnett dated 2 December 2014."

43. The matter then came on before Chief Master Marsh for directions at a hearing on 9th February 2015. The application to amend was unopposed. Mr Kaye had provided yet a further (third) witness statement (dated 26th January 2015) describing the issues thus:

> "In very simple terms the issue between the parties is whether the Defendant is entitled to "Interest Rate Swap termination costs" (per its letter of 27 May 2014), or alternatively the costs of an "Internal Swap" (per paragraph 13 of its solicitor's witness statement of 2nd December 2014).

> He describes the amendment as being intended to remove any doubt that the court could consider the claim made by the claimants. The court was invited to consider the issues so that the claimants could know "whether they are liable to pay a very substantial sum to the Defendant, if they choose to redeem their loan".

44. Mr Warwick provided a skeleton argument for the hearing before the Master. He described the action as being commenced "specifically for the court to determine whether the borrowers pursuant to the Agreement had a liability for the "Interest Rate Swap termination costs"". He went on to quote paragraph 13 of Mr Barnett's witness statement and said:

> "9. Thus it emerges that the Defendant, without entering into any agreement with the Borrowers, took upon itself the arrangement of some kind of "Internal Swap", and it claims that the Borrowers are liable for all the costs of this "Internal Swap". The Defendant will not permit the Borrowers to redeem their loan without requiring payment of the cost of the "Internal Swap". Thus the key issue in the case is whether the Borrowers are liable for the "costs" of the covertly incurred "Internal Swap"."

45. The bank's skeleton argument for the hearing in front of the Master continued that theme. At paragraph 2 it said:

> "As set out in paragraph 13 of Mr Barnett's Witness Statement, D entered into an interest-rate swap to fund the interest on the loan."

Thus the action had become firmly set on the tracks of a consideration as to whether or not the bank could recover the costs of its internal swap. Mr Taylor sought to present the case as though that limiting of issues was somehow of the claimants' own choosing. That is a false portrayal of what had happened. It is true that the action was now focused on that particular issue in relation to that particular swap, but that is because the bank had set it on that track by stating clearly that this was the basis of its break costs claim. It had never made any suggestion that there was any other swap (or indeed any other funding transaction), and had implicitly and expressly denied that there was any external back to back swap, which could be the basis of a similar claim. So the issue which had been made to arise was the result of what the bank had clearly said, not because of some choice (informed or otherwise) on the part of the claimants who could, of course, have no knowledge of what the bank had been doing behind the scenes.

46. There is a transcript of the hearing before the Master. The Master is recorded on the first page as saying:

> "It is really a simple question of construction, is it not?"

to which Mr Warwick replied in the affirmative. At page 9 the Master observed that "the parties had finally landed on what the issue is, which is a very short issue of construction…". There was then a debate about whether any further evidence could or should be filed and the Master allowed limited evidence confined to the factual matrix of the loan agreement. That is reflected in paragraphs 3 and 4 of his Order. His Order also gave permission to amend the claim form as proposed.

47. In response to Mr Kaye's new evidence and the amendment, Mr Barnett filed his own further (second) witness statement. In paragraph 11 he took up the question of whether the internal swap was a "funding transaction" and he said:

> "11. Second, Mr Kaye takes issue (at paragraph 15 of his second statement) with whether or not the Bank's Internal Swap was a "funding transaction" within the meaning of clause 12.1(f) of the Loan Agreement. In this regard, I refer to paragraphs 13 and 18 of my first Statement. By way of further evidence as to the nature of the funding by the Bank of the Loan to MP35, I am informed by the Bank and believe that:
>
> …
>
> (e) In order to fund any future shortfall between the fixed rate of interest received under the Loan Agreement and the floating rate of interest being paid to Group Treasury, and as part of funding the Loan, Corporate Banking entered into the Internal Swap with the relevant Markets Desk (in this case, the sterling rates Markets Desk) for the relevant tenor rate and notional amount, essentially mirroring the characteristics of the Loan. The Markets Desk sits within the Bank, and is not a separate legal entity.
>
> (f) The Markets Desk will, in turn, fund the Internal Swap by entering into an interest rate swap with an external market counterparty. As set out in my first Witness Statement, the Markets Desk manages the Bank's sterling interest rate risk on a portfolio basis by aggregating that interest rate risk. This

> means that each sterling swap booked internally is not necessarily funded externally on a "back-to-back" basis.
>
> (g) The Internal Swap is, therefore, a funding transaction without which the Bank would not be able to offer the (fixed rate) Loan, the costs of unwinding of which is a cost of the "unwinding of funding transactions undertaken in connection with the Facility" (clause 12.1(f) of the Loan Agreement)."

48. Thus Mr Barnett addressed the question of the internal swap being a funding transaction, and he did so in terms which clearly suggested that there was no other candidate for a funding transaction. Although his witness statement did not say so in terms, it is completely inconsistent with the idea that there was a matching back to back transaction with an external counterparty. Mr Barnett's evidence, in my view, shows that the bank was still (and plainly) approaching the proceedings and the forthcoming hearing on the footing that the issue, and the only issue, between the parties, was whether or not the internal swap amounted to a "funding transaction". It was doing that not because the claimants had somehow lighted upon that idea and wanted that point, and that point alone, decided, being uninterested in any other candidates. The claimants adopted that view because the whole tenor of the correspondence and the witness statement evidence was that the bank was proposing the internal swap as the only candidate for being a "funding transaction" within clause 12.1(f).

49. Mr Taylor submitted that what Mr Barnett was doing was confining his evidence to what was actually ordered, namely the factual matrix relevant to the construction of the contract. In those circumstances he was careful not to stray beyond the issues in question. That is said to explain why he confined his evidence to the internal swap. Whether there was an actual back to back swap with an external counterparty was irrelevant to the question which the bank was being asked to determine. I do not accept that interpretation. First, paragraph 11 of his Witness Statement dated 27th February 2015 does not deal with the factual matrix of the loan agreement. It deals with the nature of the interest which the bank sought to bring within clause 12.1(f). That is not factual matrix. It is, however, plainly relevant because one has to understand what the relevant transaction is before one can decide whether it is capable of falling within clause 12.1(f). Mr Barnett is dealing with the point not because the claimants happen to have raised it, but because it had become the central feature of the claim <u>because the bank had said that it was the central feature</u>. In other words, by now the scope of the debate in terms of the transaction which is said to be relevant to clause 12.1(f) (and the attempt to recover interest rate swap costs) had been specified by the bank. That is why the claimants took it up. It was not some flight of fancy, piece of guesswork, or choice from several candidates on the part of the claimants. They had asked why the charge was proposed; the bank said it was because of the internal swap; and the bank had said (by now more than once) that there was no external swap which was effectively a back to back transaction, because the bank

hedged into the outside market on a portfolio basis. As will become apparent, this stance was maintained throughout the hearing before Warren J.

50. The hearing before Warren J took place on 13th May 2015. By way of preparation for that hearing each of the parties prepared skeleton arguments. The skeleton argument of Ms John for the bank correctly identified the issue as follows:

> "1…The issue is whether Cs are (or, more accurately, would be) in the event of early termination liable to indemnify D in respect of losses D may suffer in unwinding a hedging transaction entered into by D in connection with the Agreement."

That is plainly a reference to the internal swap, as Mr Taylor accepted. The same is true of her paragraph 7:

> "The ambit of the dispute is narrow, Cs maintain as a matter of construction they are not liable in any circumstances to indemnify D for any loss suffered as a result of the hedging transaction D entered into in connection with the Agreement."

There is a further reference to the internal swap in her paragraph 9. In other words, and not surprisingly, the skeleton argument sought to justify why it was that the internal swap fell within clause 12.1(f).

51. The scope of the transaction or transactions which were to be the subject of debate emerged right at the beginning of the hearing before Warren J of which a transcript has been made available. Before Mr Warwick even opened his case, Warren J asked some questions of Ms John:

> "**Mr Justice Warren**: …The only interest rate swap that we are talking about is the one referred to in Mr [Barnett's] First Witness Statement at para. 13, I believe, which is what you have called the Internal Swap; yes? Or is there something else?
>
> **Ms John**: Well, My Lord, that has a knock-on effect on the bank's Markets Desk, takes a portfolio aggregate view and enters into an external market swap on the basis of its potential

> exposure. So it is an individually specified transaction, as it were.
>
> **Mr Justice Warren**: The internal swap is purely between divisions of the bank?
>
> **Ms John**: Correct.
>
> **Mr Justice Warren**: There is no contract underlying it, obviously, therefore?
>
> **Ms John**: That is correct.
>
> **Mr Justice Warren**: It is simply within the bank. There is no specific, this is the question, there is no specific external hedging transaction directly at the Loan to the Syndicate?
>
> **Ms John**: Not readily identifiable back-to-back specific, no My Lord."

52. This exchange demonstrates the focus of the proceedings, and why it was the focus. In my view it demonstrates the following important points. First, not surprisingly, it was confirmed that the debate was to be about the internal swap. Second, the bank was not maintaining that there was an external swap which was an alternative (or better) candidate. In fact, Ms John effectively said there was not one. Third, it demonstrates that the reason that no specific back to back transaction was the subject of debate was not because the question had not come up, but because there was nothing to debate. All Ms John was reserving (by implication) in her opening remarks was the possibility of arguing that the portfolio costs could somehow be taken into account. At page 17 Warren J noted that he had specifically been told there was no external interest-rate swap specifically focussed on the contract.

53. Ms John maintained her way of putting the case throughout the hearing – that is to say she argued that the internal swap, with portfolio-based external swaps, entitled the bank to make the claims that it had intimated it would make in the event of redemption. That emerged at various points in the transcript:

"**Mr Justice Warren**: …I did not understand it to be Mr Warwick's position that if there had been a hedging transaction which they knew about with a third party that it could not fall within cl.12.1 (f); is that right or wrong?

Mr Warwick: That is right, My Lord.

Ms John: I understand that, except for the reference to which they did not know about, which I assume is whether or not it falls within that and in cl.12.1(f) or not being the question.

Mr Justice Warren: It is not our case anyway, so it is a matter for – I mean the principle is that you could have a hedging transaction that was caught by 12.1(f), he accepts that.

Ms John: Well, My Lord, we do say there was a hedging transaction or transactions, it depends how one wants to view it, that is caught by 12.1(f) and as your Lordship asks the question I will answer it squarely, which is that that is the internal swap between the two divisions of the bank, one division paying the other and, as you rightly said, My Lord, accounting entries but there is a proper transaction. But in terms of loss, whether the bank can suffer any loss as an entity, what the bank does as, I would say, part and parcel of that transaction is hedge its portfolio position on the basis of the internal swaps and they have a number of internal swaps, including the claimant's, the one in relation to the claimant's loan, and it hedges its position with external parties on a portfolio basis as a result of that.

Mr Justice Warren: So that is a different transaction?

Ms John: Well, it is. It is a different transaction, but it is a linked transaction.

Mr Justice Warren: But which is "the transaction" which we have to focus on for the purposes of 12.1(f)?

Ms John: My Lord, you can either view it as two transactions, and they are both the transactions we rely on, we rely on both transactions, or they are part and parcel of the same transaction; first of all an internal arrangement and then an external arrangement externally, which would cause the bank to suffer loss. The bank cannot suffer loss, we accept the bank cannot suffer loss if it is only an internal transaction, My Lord.

Mr Justice Warren: You accept that?

Ms John: Yes, we do accept that. The reason why we say we have suffered a loss is because the bank goes out to the market and hedges its position on a portfolio basis. That means that the portfolio of internal swaps it has. Because all the money that is coming in, taking it in real terms, the only money that is coming in is the fixed amount of interest coming in from the borrowers." (pages 28-30).

…

"Mr Justice Warren: …What is the funding transaction which is undertaken in connection with the facility?

Ms John: Well, I do not believe – it is probably my inelegance of expression. But what my answer is, I hope, consistently, it has been both the internal swap and the market – the position that is taken in relation to the market.

Mr Justice Warren: But what is the transaction that it has taken in relation to the market?

Ms John: It is a portfolio position that it adopts. It is not specifically referable to, i.e. it is on a back-to-back contract. You would have Contract A, the internal swap, Contract B, the external swap. You have got Contract A, the internal swap, and

> then you have got the bank taking a position on a wider broader basis in relation to all of its internal swaps." (page 30).

54. There are further exchanges in the same vein. What the parties, and particularly the bank, thought they were addressing at the time also emerged in the context of how far, if at all, it was appropriate to go in assessing loss. At page 72 Mr Warwick addressed Warren J on the difficulties of justifying any particular figure claimed by the bank, and then the following exchange took place:

> "**Mr Justice Warren**: They cannot tell you, because they do not know until they actually have to unwind the hedge what they will do.
>
> **Mr Warwick**: Well, what we have not even got, you see, we are told there is a portfolio, but we have no evidence of the portfolio. We are told it was with some other party; we do not know who the other party is.
>
> **Mr Justice Warren**: I do not know what is in evidence and what I have been told in the course of submissions.
>
> …
>
> **Ms John**: There is a slight problem trying to resolve this on a Part 8, which is why I raised this at the point of the CMC because I entirely agree with your Lordship's point, "What are we being asked to prove?" We are not claiming an indemnity, we are not saying a certain chain of events has happened therefore what are we being asked to prove and how? We are not seeking any money. We came to court addressing the principle of whether we could fall within this. There may remain over, My Lord, that is a theoretical question, there may remain over an issue which your Lordship cannot determine; "If this actually happened in practice could the bank prove it if it wanted to claim it ultimately?" Because the real Part 8 question, coming back to what I said at the beginning, is, "Could, in theory, that sort of loss fall within the ambit of this clause?" That is clearly answerable today.

> **Mr Justice Warren**: That may be so. I am sorry, that may be so, but it must be possible for a litigant to come to court to get a declaration about something that has such commercial importance as this; "Do I exercise my power to repay early or do I not?" The answer is "Well, I will do it if it is going to cost me X but not if it is going to cost me Y. They say if I do so, if I pay back the money, it will trigger the indemnity and I want to know why that would be." You are saying that it will trigger the indemnity. I do not think they are saying, and I am certainly not going to decide, how much it would be.
>
> **Ms John**: No, no, My Lord, no. But the problem is if there is going to be a dispute about that, that is not readily amenable to the Part 8, which is the point I was making at the CMC, as to how we are going to have evidence for and against that. Because we were constrained at the CMC to putting in factual matrix evidence, My Lord, not evidence of what loss we would actually suffer if we had evidentially come within Mr Justice Hurst's clause, so we are caught between a rock and a hard place there, My Lord."

It is apparent that the bank there was asserting (correctly) that there was a limit to what the court could decide on the evidence before it, because while it had evidence of the apparently relevant transaction (the internal swap) it had only generalised evidence about portfolio hedging and no evidence about the financial consequences of an unwinding. All that is premised on the assumption that the relevant hedging transaction is the internal swap and that there was no external matching back to back swap.

55. The other significant point which is relied on by the bank as emerging from the hearing before Warren J is a concession made by Mr Warwick that the losses flowing from a back to back hedging transaction (that is to say, back to back in the sense that it can be clearly linked through to the loan) would be within clause 12.1(f). Mr Warwick first gave a qualified indication of his position at page 70:

> "**Mr Warwick**: Well, if we put aside the question of knowledge and we just focus on the language used, if instead of what I might call a conventional interest-rate swap which has been entered into between the bank and my client, the bank had gone off to a true third party and entered into a bespoke arrangement for this particular loan agreement, then I can see, I am not conceding this, but then I can see that when the bank then said, "Right, we have got this one loan agreement and next to it we have this separate agreement between the bank and a

> third party and we have entered into this to hedge what we regard as our risk of moving interest rates, and if one then – or if the loan falls to be repaid, then we will unwind that bespoke arrangement," I can see how that sort of factual backdrop might fit within (f)."

Having been pressed to clarify what would happen with an external transaction, Mr Warwick then said:

> "**Mr Warwick**: Well, Mr Lord, for the purposes of this case I would then accept that just as it is possible for lender and borrower, when they enter into a loan agreement, to enter into separate interest-rate swap agreements, and it happens so frequently, as I said in my introduction, that the courts are concerned with a good deal of litigation involving that. So moving on, instead of it being an arrangement between lender and borrower it is an arrangement between the lender and a third party, what I will call the hedging institution, then this transaction is entered into with the hedging institution on a back-to-back basis essentially with the loan agreement. Then your Lordship could say that is the funding transaction that is envisaged, if indeed the parties – because it is all a notional exercise when you exercise construction, but your Lordship would then say, "What was envisaged by (f)?" The answer is, it is that type of transaction with a third party for the purposes of this – because it is in connection, it is a funding transaction in connection with a facility. So it is targeted on "the facility", as you saw, it is a defined term." (page 70).

And then at page 71:

> "**Mr Warwick**: Well, My Lord, I suspect having agreed that you could have a bespoke arrangement on the day of the loan with a third party if they then decide to do it the next day or the day after that, perhaps when they sense that interest rates are moving in a particular way, I can see the argument that that would also fall within (f), because (f) does not say – when it says "in connection with the facility" does that mean – or when it says "in connection with" it does not say it has to be on the day the facility is taken out, there has got to be a nexus that providing it is in connection with that facility if you took it out a week later or a month later then, and it is this funding transaction, that probably falls within (f)."

He then goes on to say why that does not apply to hedging via a portfolio. He confirmed his position in reply at page 79:

> **"Mr Warwick**: Well, My Lord, you have asked me a number of possibilities that would be covered by 12.1(f) and I have indicated that if the bank did take out a freestanding hedging arrangement with a third party to hedge its risk in relation to this loan agreement and if it incurred a cost in the unwinding of that then that could fall within (f). But it did not take out any freestanding arrangement with a third party."

Warren J's judgment

56. Warren J delivered his judgment on 14th August 2015. His decision was to the effect that the bank's case failed. He identified the question he had to decide as follows:

> "3. The Bank entered into an internal hedging arrangement (which I will explain in due course). The issue before me is whether the Borrowers are liable to indemnify the Bank against any "loss" suffered by the Bank as the result of this arrangement. I put the word loss in inverted commas because one question which arises is whether any "Loss" as defined in the Agreement has been incurred by the Bank in the first place".

57. He then described "the dispute in a nutshell":

> "7. More than five years have elapsed since the date of the Agreement and the making of the loan. The Borrowers are considering redeeming the whole loan. The Bank contends that, as a condition of such redemption, the Borrowers must pay an "Interest Rate Swap termination cost". As at 27 May 2014, this cost was quantified by the Bank at about £2.396 million. I was not told the precise figure as at the date of the hearing but it is clearly substantial. The Borrowers contend that such Interest Rate Swap termination cost is not within the scope of the indemnity contained in clause 12 of the Agreement since it is not a "Loss"."

58. He then referred to complaints on the part of the bank about the inadequacies of the original claim form, points which Mr Taylor makes before me. Warren J was not very impressed with them (nor, as will appear, am I):

> "11. I am not much attracted by Mr Barnett's point or with adjudicating on this particular spat. Clearly what the Borrowers are seeking in the original Claim Form is an answer to the question whether they would be liable for this cost if they were to prepay the loan. In any case, this does not much matter because the Claim Form has been amended to include a new paragraph seeking a declaration "that the Borrowers are not liable to pay [the Bank] any sum in respect of the "Internal Swap" as described at paragraph 13 of the witness statement of Michael Felix Barnett dated 2 December 2014"."

59. Having set out sections of the correspondence, the dependency of the borrowers on information from the bank, and the importance of the bank's stated position, was alluded to in paragraph 15:

> "15. The reader of this correspondence would have no reason to think that the hedging transaction to which the Bank was referring was other than a purely internal matter although I am bound to say that, at that stage in October 2014, the nature of the internal arrangements had not been adequately explained to the Borrowers' solicitors or, indeed, at all. There is no reference in the correspondence to an external hedge with a third party: if there had been one, it might have been expected that the Bank would have given to the Borrowers some information about it. But this was not done. In any case, if there had been anything other than some internal arrangements, the second passage quoted from the 20 October 2014 letter would have been wrong."

The passage to which the judge referred has been set out above - it begins: "We consider we have responded to your query:". The judge went on:

> "16. On any view, and the Bank does not suggest otherwise, there was no hedging agreement entered into between the Borrowers and the Bank."

60. Before turning to the main question of construction Warren J set out the basis on which he considered the proceedings were brought. These are significant passages:

> "28. The fourth point is a rather longer point and concerns precisely what it is that I am to decide. The Claim Form was formulated in the light of the correspondence and the position

which the Bank had taken. The Borrowers' solicitors had consistently (albeit misguidedly or unreasonably in the Bank's view) sought details of the funding transactions on which the Bank would rely were the Borrowers to make a prepayment. Like a mortgagor seeking to redeem, the Borrowers sought the basis on which the Bank had based its calculations of the amount which would fall due. Although clause 21.2 of the Agreement provides that any certification or determination by the Bank is *prima facie* evidence of the matters to which it relates, the provision of figures is no more than *prima facie* evidence of the correctness of the figures. It does not mean that the Bank can simply decline to explain the legal basis on which the calculation is based. In the end, the Bank, in its letter dated 20 October 2014, pinned its colours to the Internal Swap as the relevant funding transaction, expressly disavowing reliance on any other funding transaction.

29. It was on that basis that the original Claim Form was drafted. The complaints about the deficiencies of the Claim Form did not go to that aspect of the dispute. The Borrowers' case in the litigation has always been that the funding transaction relied on by the Bank (and it was in fact the only funding transaction relied on by the Bank until much later as I will explain), that is to say the Internal Swap, was not within the scope of clause 12.1(f) of the Agreement. In case the Claim Form did not seek the right relief in the light of AG's [Addleshaw Goddard's] observations about its deficiencies, the amendment which I have already mentioned was made. It did not, in my view, introduce a new claim which would have justified the Bank in saying that a totally new point was now being made and that it was not, after all, the case that there was some funding transaction other than the Internal Swap which would give rise to an indemnity under clause 12.1(f) were the Borrowers to make early payment.

30. I had thought, before the hearing began and having read Ms John's skeleton argument, that the Bank's case remained that the relevant funding transaction was the Internal Swap. But as the argument developed, it became apparent that this was not so. It remained her primary position, on behalf of the Bank, that the Internal Swap was the relevant funding transaction. But if that was not so, then the relevant funding transaction was the Internal Swap taken together with the arrangements with third parties by which the Bank manages its risk on a portfolio basis.

> 31. I will, of course, answer the question raised in Claim Form which is whether the Internal Swap is a relevant funding transaction. I will also deal to some extent with the issue whether the Internal Swap taken together with any sort of external hedging is a relevant funding transaction. But I will not address (other than tangentially) the question whether an external hedging transaction is capable of being a relevant funding transaction. I will not do so because it has not been argued, or at least properly argued, and whether the particular arrangements entered into by the Bank with third parties which cover its exposure in relation to the loan to the Borrowers will depend on the details of how the Bank manages its risk on a portfolio basis. As to that, I have no evidence but only some rather general explanations given by Ms John and which, even if they were uncontroversial, are not of sufficient detail to enable me to reach a conclusion.
>
> 32. Whether the Bank is precluded from relying on such arrangements as relevant funding transactions for the purposes of clause 12.1(f) is not a matter for me in this litigation. The Borrowers may have a case for saying that the Bank is precluded from doing so having allowed the Borrowers to come to court on the clearly stated basis that the Bank was relying only on the Internal Swap as the relevant funding transaction. Further, although Ms John did set out the secondary position that the relevant transaction was the Internal Swap together with the external arrangements on a portfolio basis, she did not seek to argue that the external arrangements alone were a relevant funding transaction. No doubt she would say that she did not do so because that was not a question raised by the Claim Form. But if the point is raised in the future, it may be that the reason it was not raised by the Borrowers on the Claim Form will be relevant to whether it can, at that future time, be raised by the Bank, that reason, of course, being that the Borrowers were told by the Bank that the only relevant funding transaction was the Internal Swap."

61. What the judge is putting on one side as not being ruled on by him is any form of focused consideration of the portfolio hedging to which reference had been made by the bank. He is not leaving open the possibility of a real back to back matching transaction. The bank had expressly disavowed that and the judge had already noted it.

62. At paragraph 49 Warren J recorded the concession made by Mr Warwick as to whether a true back to back external hedging arrangement would fall within 12.1(f):

> "49. The point was also made that Mr Warwick has at no stage indicated what clause 12.1(f) does cover if it does not cover the facts of the present case. As to that, Mr Warwick accepted, in his reply submissions for the purposes of the present claim, that a specific hedging transaction by the Bank with a third party, back to back with the Facility, would be covered by clause 12.1(f). But he did not accept that it would include the external hedge arrangements on a portfolio basis which the Bank in fact transacted with third parties. As I have already explained, that is not an issue which is raised on the Claim Form and is not one which I am willing to address."

63. At paragraph 50 Warren J started to express his conclusions. At paragraphs 50 and 51 he determined that the internal swap was not itself a "funding transaction" within the meaning of the definition of Loss in the agreement or of clause 12.1(f), ignoring for the moment any external hedging. At paragraph 53 he considered whether the existence of external hedging on a portfolio basis makes a difference to that conclusion, and he held that it does not. Then at paragraph 55 he considered whether the external swap and external hedging can (presumably together) amount to a "funding transaction", and again he concluded that they cannot. At sub-paragraph (iii) he recorded:

> "iii) Although Mr Warwick accepts that a back-to-back hedge is a "funding transaction", he does not accept that that is the case in relation to the actual arrangements in the present case. For reasons already given, that is not an issue on the Claim Form and I do not have the material to decide it."

64. Warren J expressed the disposition in paragraph 56, with one potential qualification:

> "56. I will make the declaration sought by paragraph 3 of the Amended Claim Form to the effect that the Borrowers are not liable to pay to the Bank any sum in respect of the Internal Swap. But this is not to be taken as a decision that the external hedging arrangement on a portfolio basis in the present case is not a "funding transaction" within the meaning of the definition of "Loss" or within the meaning clause 12.1(f). I am not, however, concerned in this litigation with any question whether it is open to take that point at any later stage."

Thus the point in issue in those proceedings was decided against the bank.

Post-judgment events

65. Warren J refused the bank permission to appeal. The order encapsulating the judge's order was dated 2nd October 2015. It appears that shortly before then the bank conducted a search of its documents and found the external swap that is now said to be a, or a potential, back to back swap capable of being a funding transaction for the purposes of clause 12.1(f). It informed the claimants of this document on 1st October 2015.

66. Lewison J granted the bank permission to appeal on 11th January 2016. In its notice of appeal the bank said:

> "16. However, in the light of the Judgment, the Bank also reserves its right to claim an indemnity on the basis left open by the Judge, i.e. by reference to any external transactions that might be unwound on prepayment. The Bank is investigating the external arrangements made when the Loan was advanced in 2004, and has written to the Borrowers in such regard. The Bank's rights to claim on that basis is outside the scope of the part 8 proceedings and any appeal."

67. Mr Warwick disputed whether that was a correct summary of the judge's reservation, and I think he is right about that, but that probably does not matter. On 28th July 2016 the bank filed a request for its appeal to be dismissed, and it was duly dismissed on 9th August 2016. The reasons for not pursuing the appeal are referred to by Mr Barnett in a witness statement filed in this action:

> "57. Ultimately, in circumstances where the Bank had found the market counterparty interest-rate swap, and in light of the concession made by Leading Counsel for the Part 8 Claimants, the Bank decided not to pursue its appeal any further, as such a course of action appeared to be unnecessary both substantively and in terms of the parties' and the Court's time and resources."

The commencement of this litigation and the applications before me

68. This claim was started on 15th September 2016 in the face of an assertion by the bank that it is entitled to rely on the newly found external swap transaction for the purposes of clause 12.1(f). In July 2016 Kaye Tesler had asked for a redemption statement and the bank responded with one showing a hedge unwinding cost of over £4.7m. The

increase over the previously claimed sums caused concern (if not something stronger) on the part of the claimants, and in any event the claimants disputed the bank's entitlement to raise the point now. The Particulars of Claim in these proceedings describes the action as being one which "seeks to enforce the right of redemption of the charge, without payment of the Swap Cost" (paragraph 5) and go on:

> "6. Since it is the Claimants' contention that a renewed attempt by the Bank to justify recovery of the Swap Cost would be barred by estoppel and/or be an abuse of the process of the Court, the Claimants set out hereafter a summary of the background."

The previous litigation is summarised and the new redemption statement is referred to. Paragraph 33 pleads:

> "33… By reason of the history set out above the Bank is not entitled to require the payment of any Swap Cost as a condition of redemption of the Charge. The Bank's claim is res judicata (this term being used to extend to the several principles adumbrated by Lord Sumption in paragraph 17 of his judgement in *Virgin Atlantic Airways Ltd the Zodiac Seats UK Ltd* [2014] AC 160)."

69. The Particulars claim a declaration that upon the claimants redeeming the charge the defendant is not entitled to be paid any sum in respect of "Swap Cost", and an order that on payment of the sum due pursuant to the loan agreement, excluding the Swap Cost, the claimants are entitled to redeem the property free of the charge. The action is thus in substance a sort of redemption action, and at its heart is a claim that the bank is no longer entitled to claim the cost of unwinding the external hedge even if it would once have been entitled to do so.

70. The claimants' application notice seeking summary judgement was issued on 2nd December 2016, supported by a witness statement of Mr Kaye. That witness statement effectively sets out the history of the matter and avers that the bank has no real prospect of successfully defending the claim. There was a response from Mr Barnett, most of which I do not need to deal with in this judgment. However, he does deal at various points with the question of what the bank knew and did not know from time to time, and how the external swap emerged, which is relevant to the applications before me. In paragraph 24 he says this:

> "24. My firm was assisting the bank in relation to this correspondence at this time, and I recall that we had been struggling to understand exactly what KTC [Kaye Tesler] were

> after, that we have not already told them. We had been endeavouring throughout this period to correct misconceptions about possible external interest rate swaps with the Claimants, and the position in relation to the amount of break costs payable in respect of the Bank's internal funding arrangements in the event that the loan was repaid. So when responding to KTC's specific questions to the Bank in its 7 October letter, including "to identify each and every funding transaction that the bank allegedly undertook in connection with the Facility" and to identify "each funding transaction… The cost to the Bank incurred in the unwinding of that transaction…", The Bank was simply seeking to reiterate the position that we had been trying to explain previously – that the Part 8 Claimants had not entered into any swap and the "Interest Rate Swap termination cost (MTM)" was based on the internal swap that had been the subject of correspondence. There were no other funding transactions that had given rise to this potential MtM liability on redemption, which figure had already been provided by the bank… For that reason, the Bank simply did not have in mind and did not therefore provide detailed explanations of the mechanics of its own financing arrangements for the loan in this context."

71. In paragraph 47 he explains why he gave the evidence that he had previously given about the banks are funding arrangements (paragraph 11 of his earlier witness statement). He explains:

> "47. In providing those explanations, given how matters had been left at the hearing before Chief Master Marsh, we felt that there was no need or indeed justification for our spending time investigating in detail and endeavouring to put in evidence the exact funding arrangements which had in fact been made by the Bank in making a fixed rate loan available to MP35 and what the Bank would actually do if the loan was repaid, which would in any event raise factual issues unsuitable for Part 8 determination. Further our understanding was that the Bank's interest rate risk was generally hedged across the Bank on a portfolio basis, and that the prospects of there being a bespoke "back-to-back" trade hedging its risk in the market were unlikely and any such trade would be difficult to identify. Indeed, those instructing me and our legal team proceeded up to and including trial on the understanding that that was the case. As a result, other than speaking to staff within the Bank regarding the usual approach taken to funding fixed rate loans, no searches for information and documents relating to external hedging in place at the time of the fixed rate loan made available to MP35 were undertaken in preparing the evidence."

He returned to the point in paragraph 55:

> "55. From my own involvement at the time, I am aware that the bank did not know of the existence of this trade until that date [i.e. September 2015]. A search for a possible external swap was prompted partly because of the express concession made by Counsel for the Claimants at trial and the judgment, and partly by a desire on the part of the Bank to establish whether the judgment might affect any other relevant trades. In the event the Markets division within the Bank was asked to carry out a "drains up" investigation into whether this transaction was hedged with a separate swap (rather than across the whole portfolio), and a vanilla interest rate swap was identified as having been entered into on the day of the Internal Swap which corresponded so closely with the Internal Swap that it was deduced that it was put on in order to hedge that internal exposure. The reason why unusually a separate swap was entered into in this case was the unusually long tenor of the internal swap (corresponding with the loan) and the magnitude. Ultimately, the prior belief that there was no other transaction relevant to the Part 8 Claimants' complaints was honestly held. Neither the Bank, nor anyone in my firm, harboured an intention to mislead the Part 8 Claimants or the Court. Has set above, given that the issues which were to be determined in the Part 8 Proceedings were issues of contractual interpretation and given the express restriction on the Bank's ability to file evidence in those proceedings, no searches for information and documents relating to funding arrangements for the fixed rate loan made available to MP35 had been undertaken in preparing the evidence."

72. As I have already indicated, the bank has issued its own cross-application seeking summary judgment against the claimants on the footing that their claim has no prospects of success.

The parties' respective cases on these applications

73. At the heart of the claimants' case is the wider *res judicata* doctrine, and in particular the principles emerging from *Henderson v Henderson* (1843) 3 Hare 100, as recently elaborated in *Johnson v Gore Wood* [2002] AC 1. The claimants say that the bank could and, in the circumstances should, have put forward its newly discovered external swap as a "funding transaction" in the first proceedings and it is now too late to do so. The defendant refutes that and says that the suggestion is unsustainable.

74. The claimants' case is that the first trial was intended to determine whether the claimants could be liable for swap costs in the event of redemption. The bank litigated the matter on the footing that the swap it was claiming under and in respect of was the internal swap (without or without the portfolio hedging). That is emphasised by the extracts from the evidence, correspondence and submissions that I have set out above. If it was going to rely on a specific external hedge it could and should have put it in issue in the proceedings. This was not just a case of a cause of action, or defence, not being put forward; it was actually disclaimed. That makes it an even stronger case for the application of *Henderson* principles. The present proceedings amount to harassment as that word is used by Lord Bingham in *Johnson.* Mr Warwick rejected criticisms that the Part 8 proceedings were originally inadequately drafted, and suggestions that Part 8 proceedings should not have been used at all. They were appropriate in all the circumstances and they generated a result. The claimants were trying to find out what they were obliged to pay, and the claim form (particularly paragraph 2) made that clear. This was not even a case where the bank did not know of the external swap. The bank actually managed to find it when it looked, and it would seem that it did not advance an argument based on it because the right questions were not asked and searches were not made before or during the first proceedings. The knowledge was there; it was just not present in the lawyers or litigators.

75. The bank did not dispute the central principles of *Johnson* type abuse or estoppel, but said that for various reasons they did not apply so as to prevent the bank relying on the external swap now. Warren J recorded that he was not deciding whether an external swap could amount to a "funding transaction". The concession made by Mr Warwick at the first trial to the effect that an external back to back swap would fall within clause 12.1(f) meant that the claimants now had no basis for claiming that such a swap (if it comes to light, which they say one has) should not be brought into account in any proposed early redemption. The external swap has never been the subject of judicial determination, so the bank is not re-litigating something that has been decided; nor is the bank mounting a collateral attack on the judgment of Warren J. The bank was and is a defendant in each set of proceedings, and has not sought a judicial determination as to its right to indemnity, and there was no duty on the bank, as a defendant to Part 8 proceedings, to raise issues other than the issues specifically raised by the claimants for determination by the court. Indeed, the Part 8 procedures do not admit of that. The evidence at the first hearing did not admit of any determination about external back to back swaps because it was confined (by the order of Chief Master Marsh) to evidence of factual matrix. There is nothing unjust, unconscionable or harassing in the bank now seeking to assert the external swap. It is said that Mr Barnett's evidence made it clear that there were external transactions connected with the swap - see paragraph 13 of his first witness statement and paragraph 11 of his second. When it came to the hearing the wider potential liability to indemnify the bank by reference to unwinding external hedging arrangements was expressly not determined by the judge. Any suggestion that the bank should have taken the necessary steps to discover the external swap was rebutted - there was no positive duty on a party to exercise reasonable diligence to discover all its claims and defences. The bank did not undertake any investigation of its underlying financial

transactions, not least because it was not understandable what "question" the claimants were asking or what they were seeking. When the claim was clarified by amendment, the claimants "chose to narrow the scope of their claim", rather than pursuing a course by which the bank would have been able to investigate its underlying financial arrangements fully. The bank did not keep the external swap up its sleeve; it simply did not know about it, and should not be penalised for that state of ignorance. Since the claimants conceded at the hearing before Warren J that an external back to back swap, and the losses resulting from it, would be within clause 12.1(f), there is nothing unjust in now allowing the bank to assert such a swap; and indeed, it would unjust to prevent it.

76. It will be useful to have firmly in mind one central point that seems to me to underpin, or at least colour, most if not all of the bank's case. It is this. The claimants (it says) chose to formulate the issue for the court in a narrow way, focusing on the internal swap, and to use Part 8 proceedings which intensified the particular focus that they chose. In those circumstances, the adduced evidence was limited (to factual matrix evidence) and there was no call on the bank to make wider inquiries. It was therefore justified in not doing so, the result of which was that it did not find the external swap. I shall consider the accuracy of that analysis in due course.

The relevant law

77. Although the leading case on this is now *Johnson v Gore Wood* (supra), and although it has been firmly said that pre-*Johnson* cases should generally no longer be cited (*Aldi Stores Ltd v WSP Group plc* [2008] 1 WLR 748 at 757A, per Thomas LJ), it is useful in this case to start with the key citation from *Henderson v Henderson* (1843) 3 Hare 100 because it has significant things to say about knowledge. The relevant passage was cited by Lord Bingham in *Johnson* at page 23:

> "In trying this question, I believe I state the rule of the court correctly, when I say, that where a given matter becomes the subject of litigation in, and of adjudication by, a court of competent jurisdiction, the court requires the parties to that litigation to bring forward their whole case, and will not (except under special circumstances) permit the same parties to open the same subject of litigation in respect of matter which might have been brought forward as part of the subject in contest, but which was not brought forward, only *because they have, from negligence, inadvertence, or even accident, omitted part of their case*. The plea of res judicata applies, except in special cases, not only to points upon which the court was actually required by the parties to form an opinion and pronounce a judgment, but to every point which properly belonged to the subject of litigation, and which the parties,

> *exercising reasonable* diligence, might have brought forward at the time."

78. I have emphasised words to which I will have to return in due course. Lord Bingham went on to say:

> "Thus the abuse in question need not involve the reopening of a matter already decided in proceedings between the same parties, as where a party is estopped in law from seeking to relitigate a cause of action or an issue already decided in earlier proceedings, but, as Somervell LJ put it in Greenhalgh v Mallard[1947] 2 All ER 255, 257, may cover
>
> "issues or facts which are so clearly part of the subject-matter of the litigation and so clearly could have been raised that it would be an abuse of the process of the court to allow a new proceeding to be started in respect of them."

He went on to elaborate the basis of the doctrine at page 31:

> "But Henderson v Henderson abuse of process, as now understood, although separate and distinct from cause of action estoppel and issue estoppel, has much in common with them. The underlying public interest is the same: that there should be finality in litigation and that a party should not be twice vexed in the same matter. This public interest is reinforced by the current emphasis on efficiency and economy in the conduct of litigation, in the interests of the parties and the public as a whole. The bringing of a claim *or the raising of a defence* in later proceedings may, without more, amount to abuse if the court is satisfied (the onus being on the party alleging abuse) that the claim *or defence* should have been raised in the earlier proceedings if it was to be raised at all. I would not accept that it is necessary, before abuse may be found, to identify any additional element such as a collateral attack on a previous decision or some dishonesty, but where those elements are present the later proceedings will be much more obviously abusive, and there will rarely be a finding of abuse unless the later proceeding involves what the court regards as unjust harassment of a party. It is, however, wrong to hold that because a matter could have been raised in earlier proceedings it should have been, so as to render the raising of it in later proceedings necessarily abusive. That is to adopt too dogmatic an approach to what should in my opinion be a broad, merits-

> based judgment which takes account of the public and private interests involved and also takes account of all the facts of the case, focusing attention on the crucial question whether, in all the circumstances, a party is misusing or abusing the process of the court by seeking to raise before it the issue which could have been raised before. As one cannot comprehensively list all possible forms of abuse, so one cannot formulate any hard and fast rule to determine whether, on given facts, abuse is to be found or not. Thus while I would accept that lack of funds would not ordinarily excuse a failure to raise in earlier proceedings an issue which could and should have been raised then, I would not regard it as necessarily irrelevant, particularly if it appears that the lack of funds has been caused by the party against whom it is sought to claim. While the result may often be the same, it is in my view preferable to ask whether in all the circumstances a party's conduct is an abuse than to ask whether the conduct is an abuse and then, if it is, to ask whether the abuse is excused or justified by special circumstances. Properly applied, and whatever the legitimacy of its descent, the rule has in my view a valuable part to play in protecting the interests of justice."

Those principles are the ones to be applied. I have emphasised words which make it plain that the doctrine of abuse involved is capable of applying to defendants and defences as it applies to claimants and claims, though it may be less often invoked against a defendant.

79. There was (obviously) no dispute about that statement as a statement of principle. Mr Taylor challenged the application of both the "could" and the "should" elements of its formulation, as appears above.

80. It would seem that it is only in cases where the second case is either clearly good or clearly hopeless that the merits of the second case can (possibly) be taken into account - see *Stuart v Goldberg Linde* [2008] 1 WLR 823 at para 57. Both sides accepted the principle. Mr Warwick said that there was no clear answer on the evidence to the question of whether the external swap was sufficiently connected to be a funding transaction. Mr Taylor said his client had "a cast iron case". I deal with this aspect of the dispute below.

81. Mr Taylor sought to make a potentially very significant point about the material that can be taken into account in deciding that the second case was an abuse. He said one should only start looking at the conduct of the parties from the commencement of the first proceedings, and one did not go back before then to carry out any sort of

investigation. He claimed to get this principle from *Virgin Atlantic Airways Ltd v Zodiac Seats UK Ltd* [2014] AC 160 at para 18ff. I am afraid I fail to see how this principle can be extracted from that authority, and it would seem to be completely contrary to the principles of *Johnson* which require all relevant circumstances to be taken into account. If one is assessing whether a party "could and should" have made something the subject of a previous piece of litigation, it seems to me to be inevitable that there would have to be some inquiry as to what preceded that litigation. It may, for example, be clear that a party did not know, and could not have known, of some important matter before the first proceedings were commenced, and that would emerge from considering matters which occurred before the first proceedings. I do not understand how else one could approach the matter. Of course, the position as at the date of the formulation of issues in the first proceedings is a vital consideration, but that reflects what has gone before. I therefore reject that submission.

82. Mr Taylor also had important submissions on what is probably an allied point, namely what is expected of a litigant in terms of working out what proceedings to bring (or defences to run). Mr Taylor sought to say that there was no duty on the bank to find out whether it had an external back to back swap (or some other funding arrangement at the time of or before the first proceedings) because there was no positive duty to exercise reasonable diligence to ascertain all the claims or defences which were open to it. He relied on what Lloyd LJ said in *Stuart v Goldberg Linde* at para 59:

> "On the other hand, it does not seem to me that there can be a general principle that a potential claimant is under a duty to exercise reasonable diligence, not yet having brought proceedings asserting a particular claim, to find out the facts relevant to whether he has or may have such a claim."

83. In my view Mr Taylor reads too much into this statement, not least because he takes it out of its context, and its context demonstrates significant qualifications. The whole of the relevant paragraph reads:

> "59 As for the relevance of a claimant's failure to use what the court might consider to be reasonable diligence in finding out facts relevant to whether he has a possible claim, it may be that this could possibly be relevant to the inquiry described by Lord Bingham, depending on the circumstances. On the other hand, it does not seem to me that there can be a general principle that a potential claimant is under a duty to exercise reasonable diligence, not yet having brought proceedings asserting a particular claim, to find out the facts relevant to whether he has or may have such a claim. Moreover, I do not see how it can be relevant at all that the claimant may have failed to use due diligence in attending to his own interests at the time of the transaction or the events giving rise to the claims asserted.

> Unless, on the merits, that is a complete and inevitable defence to the claim, it seems to me to be entirely irrelevant to the inquiry which is necessary under *Johnson v Gore Wood & Co* [2002] 2 AC 1. Nothing in Wigram V-C's observations in *Henderson v Henderson* 3 Hare 100 supports that. That, however, is the context of the master's comments on lack of reasonable diligence. If relevant at all, an inquiry as to any suggested lack of diligence on the part of the claimant would have to involve considering the circumstances of the particular claimant, including what knowledge he did have of the facts at any relevant stage, in order to decide whether he knew enough to put him on inquiry so as to try to find out more. In this context, as generally, it is also relevant that the onus is always on the defendant to show that the claimant's conduct is an abuse of process."

84. That whole paragraph reveals several things. First, Lloyd LJ was not saying that a claimant did not have to take any steps before formulating a claim. He was disclaiming a form of general principle in relation what he described as a "duty". Second, his first sentence expressly leaves open the possibility that reasonable diligence in finding out facts could be relevant. With respect, that seems to me to be an inevitable conclusion from the classic formulation in *Henderson v Henderson*, which contemplates negligent omission and points which might be taken "exercising reasonable diligence". Third, his last sentence again envisages a possible relevance of the inquiry. Fourth, what Lloyd LJ is categorically rejecting is the relevance of due diligence in the claimant's attending to his own interests at the time of the transaction or of the events giving rise to the claim. That is different from considering what a party might reasonably and properly be expected to do, in the context of an abuse inquiry, in order to determine whether subsequent litigation is an abuse. What Lloyd LJ is disclaiming is a general duty which a counter-party can use as a starting point for an argument as to what ought to have happened first time round. It does not follow from that that the court will say he needed to have done nothing.

85. This view is supported by the view apparently taken by HHJ Hacon in *AP Racing Ltd v Alcon Components Ltd* [2015] EWHC 1371 (IPEC), where he said:

> "15. It is clear that a claimant is under no general duty to exercise reasonable diligence to ascertain whether he has a potential further cause of action against the defendant (or third parties). On the other hand, in some cases the defendant may be able to show that the claimant knew enough to put him on an inquiry to find out more. Even then, it does not follow that there was an abuse on the part of the claimant, but it is relevant to the overall assessment and at a certain point the claimant's knowledge may help to tip his behaviour into an abuse."

86. I therefore consider that Mr Taylor is wrong in saying that an inquiry as to what the bank might have found out if it had been more diligent in understanding its rights in

the context of the claims being made is not a relevant factor. I think that it is capable of being relevant.

87. Last, Mr Taylor had a particular point about the application of *Henderson v Henderson* in the realms of a Part 8 claim. He relied on certain cases which he said limited the issues raised on Part 8 proceedings in such a way as to enable a defendant in the position of the bank to be able to meet just the questions raised by the claimant in the claim form without being required to raise other questions which might be thought to arise.

88. The leading authority relied on by Mr Taylor under this head was the New Zealand case of *In re Westlake* (1940) GLR 502. In that case a question of construction was raised by originating summons (the then equivalent of our present Part 8 proceedings) as to whether the interests of children had indefeasibly vested in certain events (it was held that they had). A few years later, when one of the children had died, a further originating summons was issued seeking to know whether the deceased child's interest had divested on his death. It was alleged by one party that the others were estopped from contending that the interest was not divested, because the matter was *res judicata* by reason of the decision in the first proceedings. In dealing with that point Myers CJ set out the familiar passage from *Henderson v Henderson* and said:

> "The order made in [the first proceedings] was not a decree made in an administration suit but was merely an order made on an originating summons for the determination of one particular question. It is true that a declaration on an originating summons has the same effect as a like declaration in an action and is binding in the same way… but it must be remembered that a declaratory order made on an originating summons on the construction of a will may involve but one question. If it does, then there is nothing to compel or require any of the parties to the proceedings to raise all or any other questions of construction which may conceivably arise under the will, and there is nothing to prevent further proceedings from time to time by originating summons for the purpose of determining such other questions.
>
> It seems to me therefore that the whole of the statement as laid down by Wigram VC may not necessarily apply with full force to an order under the Declaratory Judgments Act…".

89. Similar points were made in the English Court of Appeal in *In re Koenigsberg* [1949] Ch 348. Somervell LJ said (at page 363):

> "But when a trustee or anyone takes out and originating summons, he can make quite clear to those whom he has to bring before the court what point or points he wants decided, and it is for the defendants to raise and take points and file evidence which deals with the points which in the originating summons are put before the court for decision. I do not think they are called on to raise or deal with other and quite different points. But the point as to s25 [of a taxation statute] as it seems to me, is plainly not put before the court for decision in this originating summons, and I cannot myself think that the defendants were under a duty to raise it – under a duty in this sense, of course, that if they did not raise it they would not be allowed to after to assert their rights under the law as it is now held to be."

90. Mr Taylor relied on those statements for obvious purposes. He said that the same considerations applied equally to a Part 8 claim which raised a question of construction under a contract. The defendant to those proceedings deals with the question that is raised. The defendant is not obliged to raise other questions, let alone investigate, formulate and then raise them. Accordingly, he submitted that the defendant was entitled to deal with just the questions that the claimants had raised their Part 8 claim form in the first proceedings, and was not obliged to raise any questions about an entirely different transaction (the external swap). That means that it could not, and should not, have raised the external swap as a potential funding transaction in those proceedings.

91. The principles set out in those two cases in their contexts were not disputed, and, it would seem to me, are not disputable. However, their application to the facts and context of the present case is an entirely different matter, with which I shall deal in a later section of this judgement.

92. Mr Taylor cited a statement of Lord Hobhouse in *Re Norris* [2001] 1 WLR 1388 in which he said:

> "It will be a rare case where the litigation of an issue which has not previously been decided between the same parties or their privies will amount to an abuse" (para 26).

93. I assume that he cited this in order to persuade me that the present case not special enough, or the facts are nothing like strong enough, to allow the claimants to succeed. In my view it does not assist his case. First, statements as to the rarity or otherwise of

a particular remedy do not help much in deciding whether the facts of the case before the court actually justify it. What matters is whether the case can be brought within the principles, rare or not. Second, it is not clear that Lord Hobhouse had *Henderson*-type abuse in mind at all. The case before him was one in which there was an attempt to tie a third party into the effects of a confiscation order. *Henderson v Henderson* and *Johnson* (which had been decided over 6 months previously) were not cited before their Lordships. I did not find *Norris* of any assistance in the decisions I have to reach.

94. The last relevant legal point, which was again not disputed, is that the burden is effectively on the person alleging the abuse to establish it.

The application of those legal points to the facts of this case

95. I have already outlined the way in which each of the parties approach the application of the *Johnson* principles to this case. I have also identified the point which seems to me to lie at the heart of this dispute, which is whether the first proceedings were focused on one transaction only, as a matter of choice on the part of the claimants, so as to make that matter, and that matter alone, the only point which "belonged to the litigation" (to use Wigram V-C's expression in *Henderson v Henderson*); or whether the point of the first proceedings was wider than that. The bank's case is that the first proceedings were thus focused.

96. I consider the bank's position to be a mis-analysis. It is true that the first proceedings acquired the actual focus of the internal swap, but that is because the bank said that that was the relevant transaction. What emerges from the detailed chronological analysis above is the following sequence:

(a) The bank had been referring in correspondence to interest rate swap costs, in such a way as to lead the claimants to believe that a transaction to which they were a party was being asserted against them (or so the claimants thought). The bank sought to make the position clear, and informed them that what would be claimed would be the break cost of an internal swap. That was made clear by the letter of 27th May if not before. The bank was justifying its claim by reference to clause 12 and the internal swap.

(b) The ensuing correspondence made it clear that the bank was relying on the internal swap as the relevant funding transaction for the purposes of clause 12.1(f). All the correspondence made it clear that the claim (in the event of early repayment) was both justified and calculated by reference to the internal swap.

(c) That claim was challenged by the claimants. On 11th September 2014 they asked for particulars of each funding transaction relied on and details of unwinding costs. The response was on 2nd October when the bank firmly said that redemption figures had been provided. This was a re-affirmation of the significance of the internal swap. There was further re-affirmation in the bank's letter of 20th October.

(d) When the claimants started their proceedings on 14th November 2014, they were starting them against that background. The description of the swap which was referred to in paragraph 2 of the Part 8 claim form did not in terms refer to the internal swap, but the cross-reference to the May 27th letter, and what followed, will have made it clear what the claimants were asking about - the internal swap. They were asking about it not because they had alighted upon it out of a range of possible candidates. They alighted upon it because that is what the bank itself had been relying on to justify the claims that the bank indicated it would make in the event of early repayment.

(e) Mr Barnett then put in his evidence (2nd December 2014) which clearly identified the internal swap as being the funding transaction on which the bank was relying, referring to any external hedging as being on a portfolio basis and implicitly saying there was no specific back to back external swap on which the bank relied.

(f) The claimants then amended the claim form to refer more specifically to the swap, by reference to what Mr Barnett had said. Again, this was not because the claimants were exercising some sort of choice as to what to litigate over. They were litigating over what the bank had said was the transaction upon which it was relying. In the circumstances the claimants could not do anything else.

97. Accordingly, to characterise the proceedings as being proceedings in which the claimants chose their ground on which to fight, and chose it narrowly so as to leave other ground free for battle in the future, is a mischaracterisation of the situation. It was, in substance, the defendant bank which chose the ground by justifying its claims on the basis that it did. That is the claim which the first proceedings was all about, and on which the court adjudicated.

98. The truer parallel is with a redemption action, to which the first claim has close similarities. The claimants were not actually seeking to redeem, but they were seeking to understand the basis on which they might do so - a legitimate objective and one which is akin to meeting a particular disputed item of account in a redemption action. If the dispute had arisen in an actual redemption action the court would have resolved it. The same applies to a dispute about redemption, in advance of redemption, which the claimants wished to have resolved once the bank had raised its claim.

99. In a redemption action in which the amounts secured are in issue the court will order any necessary accounts and inquiries. The mortgagee would be compelled to articulate what sums he was claiming, probably via an account, though the precise mechanism does not matter. The mortgagor would then be given an opportunity to challenge any matters which he wished to challenge. The court would then rule on disputes. Thus if the present case had been a redemption action the court would have ruled on claims to recover swap costs. But it could only have done so when the bank, as mortgagee, had set out what its claim was. Once it had done that, the court would rule. The important thing to note is that in those circumstances the bank would

choose the ground on which the battle would take place, because the bank essentially has the burden of proof of sums due, and only the bank can know what sums are said to fall within clause 12.1(f).

100. What happened in the present case is something similar, but missing out some of the traditional steps because the dispute was flushed out in a different way and before an "accounts and inquiries" stage. The bank had already answered the question of what sums it wished to recover on redemption in its letter of 27th May, and it also set out the basis of recovery. It therefore did not have to do so again in the quasi-redemption action brought by the claimants. The parties were able to go straight to the relevant issue, which the claimants were able to define because the bank had already defined it. In its evidence in the proceedings the bank confirmed again what the basis of its claim was.

101. I therefore reject the proposition that the parties were just fighting on a narrow ground chosen by the claimants. The parties were fighting on the particular ground chosen by the defendant, and confirmed by the defendant in the proceedings. The position is just the same as it would have been had the claimants brought their proceedings claiming that there was no basis for any indemnity under clause 12.1(f), and the bank had responded: "Yes there is - it is the internal swap. There is no back to back external swap." It can be seen that the proceedings then continued on that basis throughout.

102. Once that is understood it also deals with Mr Taylor's points about the nature of Part 8 proceedings. It is true that Part 8 proceedings are intended to be conducted on the basis of undisputed evidence, and that they do not lend themselves to quite the process of development of issues as Part 7 proceedings. But that does not mean that his client should not or could not have raised an alternative method of claiming if it had occurred to it to do so. The mere fact that they were Part 8 proceedings did not, of itself, mean that the bank could sit back and just deal with the internal swap, without any thought as to whether that was the real issue between the parties. It had already formulated the issue itself. It was not relying on the claimants to do so. Nor is it relevant that the bank only had 14 days to put in its evidence in answer, contrary to a submission made by Mr Taylor. There is no sense in which it was somehow rushed into taking a position. It had already taken it some considerable time previously. The present case is not at all like the situations in *Westlake* and *Koenigsberg*. Those were cases of trustees seeking guidance or directions. In that situation the trustees decide what points they need to have decided in the administration of their trusts, and they join parties to argue for their respective cases. In those circumstances the trustees do indeed choose the ground on which the battle should take place (though case management may allow other ground to be identified as well). Those cases did not arise out of situations where there is a commercial dispute between two parties who have articulated the apparent basis of the dispute and who then embark on getting it decided via Part 8 because the factual material appears to be undisputed. The generic descriptions of the proceedings contained in those two cases do not apply to the present situation.

103. It also deals with Mr Taylor's submissions based on the nature of the evidence which Chief Master Marsh's order permitted. He made much of this point, and the thrust of his submission was that the proceedings were constrained to deal only with the internal swap because the evidence was limited to extrinsic evidence for the purposes of construction. In those circumstances, it was said, there was no scope for considering any other potential candidates for being a funding transaction. In his witness statement in these proceedings Mr Barnett emphasises this point. I do not think that there is anything in it. When the first proceedings were before the Chief Master the issue was apparently defined, and it is true that that issue was whether the internal swap qualified. But one has to ask why it was thus defined, and the answer is given above - it was because that is what the bank was claiming. The parties had between them defined the relevant dispute, and the Master's order was intended to limit the evidence to the apparent one and only dispute. It was not the evidential direction that imposed any restraint on the bank advancing another case; what imposed the restraint was the fact that advancing another case was not something that the bank had remotely in mind at the time. It had made its case.

104. The criticisms made by Mr Taylor of the original form of the first claim form do not advance his case. It is true that the claim form was not very specific in the relief that it sought (though paragraph 2 points in the right direction) and that Mr Kaye's witness statement in support seems to have taken a step backwards and in part pointed to an apparently non-existent swap transaction involving his clients as being an apparent justification for the charge. Although it sets out much of the correspondence I have identified above from which the point emerges, the witness statement does not demonstrate that at that time he has quite got the point and it professes bafflement that the bank could make any case. However, it was the bank's own evidence from Mr Barnett (witness statement dated 2nd December 2014) which puts the matter straight and makes clear the bank's case. Thereafter there was no real difficulty in identifying the issues in the proceedings, and the claimants got it right when they amended to refer in terms to the internal swap, which was the bank's own candidate for a funding transaction, and apparently the only one. Mr Taylor submitted that the fact that the claimants' case was not clear meant that the bank was unable to respond properly. I do not accept that. The bank did respond properly and identified its case on the issues between the parties by way of Mr Barnett's witness statement. There was no difficulty at all in doing that. Frankly, I regard these professed difficulties as being a contrivance on the part of the bank to divert attention from the fact that it did not look for any external swap at the time (see below).

105. The potential overall scope of the proceedings for the purposes of the *Henderson v Henderson* abuse doctrine was therefore not just the internal swap transaction. The "subject of litigation" (to use Wigram V-C's phrase) was what was capable of being a funding transaction, though that question arose in the context of a particular candidate put forward by the bank. In my view if there were other candidates then a dispute about them was a matter which "properly belonged to the subject of the litigation". That covers a claim based on the external swap.

106. The bank relies on what it did, or more particularly did not, know about the external swap at the time of the first proceedings. It says that the external swap was not known about, and since there is no duty to inquire how its case might be put, it is entitled to rely on that stage of knowledge (or ignorance). I have already indicated that its analysis goes too far in seeking to excuse the bank from considering its position. It is clear to me that, bearing in mind the analysis above, the bank's state of knowledge and potential sources of information are likely to be relevant to what is to be expected of it in the litigation.

107. It is necessary at this stage of the reasoning to consider what the facts relating to knowledge are. Those facts appear from Mr Barnett's most recent statement (in these proceedings) in paragraphs 47 and 53 (set out above). It is apparent that what happened was that the bank's legal team had a certain belief in how interest rate risks were and were not hedged, and dealt with Kaye Tesler accordingly. They believed that the internal swap was the only closely linked transaction, and that other external hedging beyond that was dealt with on a portfolio basis; there was no connected back to back (or similar) external swap. That belief pervaded the entire conduct of the first proceedings. Although Mr Barnett does not say so, the legal department and Mr Barnett's firm must have got the information from someone in the bank who was presumed to know about such things and who could give them reliable information. According to the evidence, it did not occur to the bank to see if there was an external hedge until or after the trial before Warren J. Remarkably, one of the triggers is said to have been what Mr Warwick conceded in argument about a genuine back to back external hedge. It was only at that point that a serious investigation ("drains up") was undertaken and the external swap discovered. Although there is no evidence about it, it is hard to believe that it was difficult to find.

108. I am prepared to assume that no individual had knowledge, in the sense of having it in his or her mind, of the external swap during the first proceedings. The bank will do so many transactions that actual knowledge on the part of an individual of a single swap entered into 10 years previously is unlikely. However, that is not the point. As a matter of corporate knowledge the bank did know, or should be taken to know, of this swap. It was in the bank's books, and a written record of it exists. It would have been apparent to anyone who looked (and in due course it was). What happened is that no-one bothered to look, probably because they had a perception of the way the bank worked which they thought made it irrelevant (hedging on a portfolio basis).

109. I find that on the facts of this case the bank should have looked. Whatever the scope of the exoneration from due diligence which Lloyd LJ's statement in *Stuart v Goldberg Linde* might confer (and I bear in mind the approval of Lloyd LJ's views in *Henley v Bloom* [2010] 1 WLR 1770 at paragraph 23), I do not think that it excuses the bank from making investigations as to how it wishes to make a claim against the claimants when an issue arises first outside and then within proceedings. I reiterate that the nature of the proceedings was such that the bank was making a positive case for the internal swap as justifying the charge it would make as being the, and the only,

funding transaction on which it was relying. "Exercising reasonable diligence" (per Wigram V-C once again) would have revealed the swap, and in my view it should have been carried out. The claimants wanted an answer and justification as to why they were being potentially charged with large sums of money. The bank was putting forward a justification. Bearing in mind the quasi-redemption action nature of the proceedings, the bank should be expected to make its full case or justification in those proceedings.

110. It follows that the bank could have put forward the external swap in the first proceedings and in my view it should have done so. There was no good reason why it should not have done so, and the claimants would have expected it if it were to be asserted. It was as naturally the subject of the first proceedings as was the internal swap. It would, in my view, amount to harassment of the claimants if they were now to face proceedings again with the bank having a second go, having done belatedly what they should have done in the first place, namely to see whether they have a potential back to back external swap available to them. The bank can no more assert that now than they could have done had there been a redemption action and they after judgment, but before actual redemption, found the external swap.

111. As a small point, I do not consider that Mr Warwick's concession before Warren J as to how a genuine back to back swap should be treated is in any way relevant to this conclusion. He was dealing with a forensic point, and his understandable answer does not now somehow open the door to the bank's propounding what it says is a sufficiently linked back to back swap. The merits of the situation are exactly the same as if he had never made that concession.

112. Nor do the merits of the bank's claim to have found a back to back external swap come into it. The position in law is that the merits would only be capable of being relevant if they were clear one way or the other. In my view they are not. The bank has presented no case other than supposition as to whether the propounded external swap has a sufficient connection. The date is the same as the loan date, but the principal is different by some £700,000 and the fixed interest rate is at least 1.5% different. No emails, letters or notes have been produced which would forge any link. I do not say that the bank's case on the point would have been hopeless, but I do say it is far from clear. I would add that I do not think that any proceedings on the point would necessarily be as short and straightforward as Mr Taylor sought to suggest. It could require quite a complex analysis of how the bank carried out its external hedging, with some consequential difficult disclosure. Such proceedings would be likely to be a "harassment" of the claimants of the nature referred to by Lord Bingham in *Johnson*.

Conclusion

113. I therefore conclude that the claimants' application succeeds and the defendant's application fails. The claimants would be entitled to resist a claim that the bank is entitled to add the break costs from the produced external swap to the redemption charges were they to redeem the loan, because to advance such a claim would be an abuse of process within *Johnson v Gore Wood*. The position is clear enough to enable summary judgment to be given on the point. The matter has been made to arise in a slightly unconventional way. The claimants have not brought an actual redemption action in which the bank is asserting its claim, and the bank has not actually, in its own action, asserted its claim. The present claim is in the nature of a claim for a ruling that if one of those things were to happen, the bank would not be able to run its point, which is a somewhat unusual way of running an abuse point. However, neither side (and particularly the bank) has taken any point on that, so I can safely decide the main point without any quasi-procedural niceties that might otherwise have arisen.

114. The appropriate form of relief can be agreed by the parties or, in the event of a dispute about it, ruled on by me.