IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2013-485-010160
[2016] NZHC 2838

BETWEEN	CYGNET FARMS LIMITED Plaintiff
AND	ANZ BANK NEW ZEALAND LIMITED Defendant

Hearing: 22-26 and 30 August 2016
Supplementary submissions received 19 September 2016

Appearances: M D Branch and K F Shaw for Plaintiff
S M Hunter, M C Smith and M H A Ho for Defendant

Judgment: 28 November 2016

JUDGMENT NO. 2 OF PALMER J
(the Substantive Judgment)

This judgment is delivered by me on 28 November 2016 at 10.45 am
pursuant to r 11.5 of the High Court Rules.

....
Registrar / Deputy Registrar

Solicitors/Counsel:
Harkness Henry, Hamilton
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Summary

[1] This is the first of several proceedings brought by customers in rural New Zealand in relation to banks' promotion of interest rate swaps to farmers before the Global Financial Crisis (GFC). Mr Craig Swan and Mrs Lisa Swan are dairy farmers in Taranaki. They also develop property. In 2007, through Cygnet Farms Ltd, they borrowed around $6 million from the National Bank to buy a dairy farm.

[2] The National Bank is now part of ANZ and I refer to it as "the Bank".[1] At the time, the Bank was promoting interest rate swaps as a financial product. The Bank represented to Cygnet that interest rate swaps were like a fixed rate loan but with upside and flexibility. It did not explain three potential downsides to swaps compared with fixed rate loans. It represented a swap was suitable for Cygnet. And it represented it would provide proactive advice to Cygnet about managing the risks and opportunities of its swaps. In January 2008 Cygnet agreed with the Bank to structure a loan of nearly $4 million in the form of two interest rate swaps. In its contractual documentation the Bank sought to exclude its liability.

[3] The swaps were disadvantageous for Cygnet when the GFC hit in mid 2008 since it could not take advantage of a precipitous fall in floating rates. In addition, Cygnet suffered from the swaps in a number of ways which would not have affected fixed rate loans and which it did not know about in advance:

(a) the Bank imposed an additional credit limit on Cygnet in relation to the swaps, which it would not have done for a fixed rate loan, and which later affected the margin it charged Cygnet;

(b) the break fees were calculated differently, and were higher, than for fixed rate loans; and

(c) the Bank increased the margin it charged on the underlying loan which it could not do on fixed rate loans.

[1] The National Bank was bought by ANZ in 2003 but the brand retained until 2012.

[4] Cygnet seeks damages for the Bank's alleged negligence, negligent misstatement, pre-contractual misrepresentation, breach of contract and breach of the Fair Trading Act 1986. All these are areas of law which can found liability for misrepresentation for similar, but not identical, reasons. I hold as follows:

(a) An exclusion clause in the contract prevents liability in contract. There is no collateral contract by which this can be escaped.

(b) The Bank's relationship with Cygnet was sufficiently proximate to establish a duty of care in tort for negligence. Some of the contractual exclusion clauses are sufficient to negative a duty of care in tort to provide reasonable advice but are not sufficient to negative a duty to provide honest, accurate and correct information. The Bank breached that duty by negligently making misrepresentations, founding liability in the torts of negligence and negligent misstatement. But s 6(1)(b) of the Contractual Remedies Act 1979 precludes Cygnet from recovering damages in tort.

(c) The Fair Trading Act claim is out of time.

[5] As sought, I make a declaration that the Bank breached its duty of care to Cygnet. But I am precluded by the Contractual Remedies Act 1979 from awarding Cygnet damages. This could be seen as a gap in the law. But it is the effect of the Act providing that the law of contract, not the law of torts, governs the awarding of damages where a misrepresentation induces entry into a contract. The Act removes the ability of plaintiffs to recover meaningful relief for a tort even when liability in tort is established and liability in contract is not. Effectively Cygnet fails to achieve anything other than a moral victory and an award of costs. Whether the law should be reformed is a matter for Parliament. I will forward a copy of this judgment to the Law Commission so it can decide whether to consider the issue for the future.

Facts

The Swans

[6] Mr and Mrs Swan are good dairy farmers with a reputation for being able to improve the profitability of farms. From 2000 they leased Mr Swan's grandmother's farm in Cornwall Rd, near Eltham in Taranaki, as equal partners in the Swan Partnership. That farm was owned by the Swan Family Trusts Partnership which had agreed any capital gain would be distributed to the Swans.

[7] Mr Swan is characterised by both parties as "entrepreneurial", or "a bit of a wheeler and dealer", with an eye to other profitable activities. The Swans have a sideline business in land development in Taranaki. In 2006, through Cygnet Land Developments Ltd, the Swans bought land at Bell Block outside New Plymouth which they started to develop and subdivide. They used second tier finance to acquire the land but subsequently, in February 2008, refinanced it with the Bank.

The Swans and the Bank

[8] Around 2007 the Swans moved their banking to the New Plymouth branch of the National Bank. Mr Mike Fleming became their RM, or rural manager or sometimes relationship manager which accurately describes the position. The Swans were happy with Mr Fleming. He had farming experience and they felt he had their interests at heart. They trusted him and they treated him as a mate. Mr Swan talked to Mr Fleming up to three times a week to discuss how things were going.

[9] As at November 2007 the Swans had two floating rate personal loans totalling $130,000 and two fixed rate home loans totalling $470,000 relating to beach properties at Mokau, north of Taranaki.

A loan

[10] In November 2007, through Mr Fleming, the Swans asked the Bank for a loan of around $6 million to purchase a new dairy farm at Finnerty Rd, not far from their Cornwall Rd property. From around 12 November 2007 Mr Fleming was on leave so they dealt with Mr Kelly.

[11] The Bank had confidence in the Swans as good operators. The purchase would be almost fully debt-financed. The security and debt-servicing terms were tight. The budget projected a cash deficit of $176,357. Any profit from the Finnerty Rd purchase would depend on production and productivity improvements. As the Swans acknowledge, their financial position was sensitive to any increase in expenses. They also put the Mokau properties on the market, though they expected that only to clear their own debt rather than to generate new net funds.

[12] On 16 November 2007 the Bank agreed in principle to fund the purchase, lending just over $6 million in return for a second mortgage over the Bell Block land and the Cornwall Rd farm. Of that:

(a) $570,000 would be a new term loan to pay the deposit and GST on the purchase;

(b) $1.5 million would be a temporary bridging loan, expected to be repaid after sale of six Bell Block sections over the next one to two years; and

(c) $3.94 million would be a new term loan.

[13] The Swans incorporated Cygnet Farms Ltd (Cygnet) for the purpose of purchasing the Finnerty Road property. They are the directors and shareholders. Cygnet agreed to purchase the farm on 23 November 2007 with a settlement date of 3 June 2008.

[14] On 6 December 2007 Mr Fleming, for the Bank, provided Cygnet with a written finance proposal to the same effect as that approved on 16 November. The loan arrangements for the new term loan still had to be structured. Mr Fleming, for the Bank, suggested a presentation on interest rate swaps.

Interest rate swaps

[15] At the most basic level an interest rate swap is an agreement between two parties in which one stream of future interest payments is exchanged for another

based on a specified principal amount. Mostly commonly, interest at a floating rate is swapped for interest at an agreed fixed rate. That is achieved by a borrower and a lender theoretically paying the other at floating and fixed rates respectively and netting out the payments.

[16] So, for example, a borrower pays interest at a floating rate under a floating rate loan agreement. But under a swap agreement the borrower also agrees to pay interest at a fixed rate to the lender and the lender simultaneously agrees to pay interest at the floating amount to the borrower. Effectively, the borrower ends up paying interest at the fixed rate only, since payment and receipt at the floating rates net out. The lender ends up receiving the fixed rate. The lender, if a bank, will usually enter a correspondingly opposite transaction on the market to hedge its risk.

[17] Converting a floating rate loan to a fixed rate obligation through an interest rate swap means each party takes the usual market risk that the fixed rate may prove to be higher or lower than the floating rate. There are, however, some relevant differences between this sort of interest rate swap and a straight fixed rate loan:

(a) Banks often arrange a separate credit limit on a swap because it creates a potential obligation between the parties to make a net interest payment if the floating rate falls below the agreed fixed rate under the swap.

(b) The term of a swap is able to be lengthened or shortened if market rates change.

(c) The credit margin[2] charged by a lender on the floating rate paid in relation to the underlying loan can be increased, unlike fixed rate loans.

(d) The way in which break fees are calculated for swaps is different to how they are calculated for fixed term loans (although the concept is similar).

[2] The credit margin is the amount of additional interest a lender adds to a base rate to reflect, for example, the creditworthiness of the borrower.

[18] From 2005 the Bank here had been promoting interest rate swaps as a new financial product in rural New Zealand, as had other banks. They were seen as a sexy new sort of financial derivative that provided flexibility in meeting customers' needs by adding to the range of credit instruments available. The promotion strategy appears to have been successful. By May 2008, Bank documentation suggests it held over $5.3 billion in its rural swaps portfolio.

[19] In hindsight, as can happen with a new product, the enthusiasm of those marketing the new product for the Bank outstripped the care taken in explaining the product to customers. By June 2009, according to internal training materials, the Bank had identified a number of significant problems in its sales methods.

The Bank's swap presentation to the Swans

[20] Mr Fleming arranged for Mr Stuart Esquilant, a specialist adviser in interest rate swaps from the Bank's Global Markets team, to give a presentation to the Swans about interest rate swaps on 17 December 2007.

[21] There can naturally be expected to be some dimming of memory of all participants of events which happened nine years before. I take into account that Mr Esquilant gave many of these presentations and does not claim to recall what happened at this one. His evidence is of what he "would have" said. Mr Fleming attended a number of these meetings too. The Swans attended only one such presentation and can be expected to have been more focussed on it.

[22] Mr Swan thought the meeting lasted 40 to 50 minutes but Mr Fleming thought it was up to an hour and a half. Mr Esquilant promoted the interest rate swaps and left the Swans with a brochure about them. He is firm in saying there was only a very slim chance he would not have used a flip chart presentation, though he does not remember doing that specifically with the Swans. The Swans do not recall him doing so and did not discover one in preparing for the case. Mr Fleming does not mention it.[3] On the balance of probabilities, I consider Mr Esquilant may well

[3] This was not addressed in Mr Fleming's evidence. Another witness Mr Schurr, a financial adviser who attended other such presentations but not this one, says he was given a flip chart to take away.

have used a flip chart presentation though he did not leave it with the Swans. Even if he did not use the flip chart, I accept that what he presented did not depart markedly from it in substance.

[23] The brochure left by Mr Esquilant:

(a) Stated that swaps, in conjunction with floating rate loans, can provide cost certainty together with some flexibility of interest rate management in the future and "any economic benefit upon early termination of [a swap] may be received by the Borrower".

(b) Explained that a swap would effectively provide fixed interest cost on all or a proportion of the amount or term of the underlying borrowing. The payments under the swap and loan "combine economically to effectively create a fixed rate cost, excluding margin" over the time of the arrangement.

(c) Stated, in relation to break costs, that if the underlying borrowing were to be terminated prior to maturity, the swap could also be "cancelled" with the Bank's agreement and a cash flow adjustment "may be received/paid by the Borrower". The brochure was clear that if interest rates moved lower:

> there will be a cost to the Bank to terminate the [swap], as there would be for terminating a fixed rate loan. However if rates have moved favourably, the [swap] will have a positive value and the benefit will be paid out to the Borrower when the [swap] is cancelled, which is not generally the case on the termination of a fixed rate term loan.

It repeats the benefit arising under termination of a swap may be passed to the borrower, but differentiates this from a fixed term loan, where the benefit would not be paid to the borrower. It does not repeat what would happen in the inverse situation.

(d) Stated that the swap can be cancelled at current market rates and a new swap substituted to take advantage of favourable movements in

the interest rate. The brochure said nothing about the cost of such changes to swap arrangements.

(e) Provided a number of qualifications, in a box in smaller font at the end of the brochure.

(f) Included a worked example at the end followed by five "Swaps Key points" of which number 4 was "[p]osition will be monitored by a treasury specialist who will provide ongoing advice".

[24] Mr and Mrs Swan were firm in their understanding of the key points represented by Mr Esquilant at the presentation:

(a) swaps were like fixed rate loans, but with upside;

(b) swaps were suitable for Cygnet Farms' business needs; and

(c) the Bank would monitor and provide advice on the swaps, throughout their duration.

[25] Mrs Swan's evidence was that she questioned what the possible down sides to swaps were and that Mr Esquilant said, historically, there had not been any real downsides where they could lose money.[4]

[26] At the end of the presentation Mr Swan indicated that he would be happy to use an interest rate swap. Mrs Swan was a bit more cautious. Mr Esquilant suggested they think it over and encouraged them to get independent advice.

Documentation and agreement of the swaps

[27] Two days later, on 19 December 2007, the Bank emailed to Cygnet the "Terms and Conditions for Institutional Financial Markets Transactions". The cover letter and the Terms and Conditions are described more fully below. The conditions

[4] Brief of Evidence of Lisa Swan at [20].

included cl 2.1 which provided the parties would be legally bound from the time the details of a swap were agreed between them.

[28] The Swans signed the Authority on Boxing Day, 26 December 2007 and returned it in January 2008. In her evidence Mrs Swan stated that she thought the purpose of the authority was for trading on the markets.[5] Neither of the Swans paid attention to the terms and conditions.

[29] There may or may not have been a telephone conversation in December 2007 in which the structure of the proposed swap was further discussed. The Bank also completed an amended credit approval, incorporating a swap credit limit, or Market Replacement Risk (MRR), of $300,000 for the Swans.

[30] On 25 January 2008 Mr Esquilant telephoned Mrs Swan to confirm the details of the interest rate swap. At that time the Bank's economic forecasts were not predicting interest rate drops. The transcript of the key parts of the conversation is:

> **Lisa**: I was just talking to Mike [Fleming] and I just wanted to check what we needed to do, do we lock in a rate or anything or is it…
>
> **Stuart**: Yeah, the way things are going I think it is probably a good idea…
>
> …
>
> **Stuart**: And for peace of mind I think, because there is so much uncertainty out there Lisa, that lets do it now rather than wait
>
> **Lisa:** Yip
>
> **Stuart:** We have had a number of issues, both domestically and overseas, that has caused a lot of nervousness out there
>
> **Lisa:** Yeah
>
> **Stuart:** At this stage, I can't remember what the rates were we were talking about before Christmas but…
>
> …
>
> **Stuart:** Now I do like the split strategy, rather than put all your eggs in one basket
>
> **Lisa**: Yip

5 Notes of Evidence 86/17.

Stuart: And would suggest we split it to the half in each of the three and five [year terms]

Lisa: Yip

Stuart: And possibly something like $2 million in the three and $1.94 in the five, or vice versa depending. The other way around will give you slightly lower costs, but my preference is the three years still. I think by then we will be well over this ugly period and rates will be well on the way down, but the five years is slightly cheaper by that .2 of a percent as well. So…

Lisa: Yip

Stuart: But if you are happy with that…

Lisa: Yeah, we will go with your suggestion and we will see how it all goes

…

Stuart: Now, what I'll do is I'll lock and load those then today Lisa, and what that does is it generates you a fax confirmation

Lisa: Yip

Stuart: Now this one we need you, just to make sure we have inputted it all correctly and sign it and fax it back to us. There is a free fax number at the top

…

Lisa: … It is bizarre thinking that you can lock it now

Stuart: Yeah, it just gives you a bit of peace of mind

Lisa: Yeah, it does, it does

Stuart: Yeah. It means you know what your costs are going to be now for at least the next three years

Lisa: Yeah that is right

Stuart: And hopefully if interest rates move up or down there is going to be some opportunities for that as well

Lisa: Yeah, hey no, awesome

[31] The same day, 25 January 2009, Mr Esquilant faxed two three-page swap confirmations to the Swans. On 27 January the Swans signed and returned them by fax. Each confirmation included, on the signature page, in capitals, with a black border highlighting it, a no-reliance clause that is analysed further below.

[32] The effect was that the Swans agreed with the Bank to enter two swap transactions effective 3 June 2008 to cover the $3.94 million new term loan:

(a) Swap 1: for $2 million at 8.15% per annum for three years, terminating on 20 June 2011; and

(b) Swap 2: for $1.94 million at 7.95% per annum for five years, terminating on 20 June 2013.

[33] On 24 May 2008 the loans for the Finnerty Road farm purchase were agreed by the Bank. Settlement of the Finnerty Road purchase occurred on 3 June 2008. The securities included: a mortgage over the Finnerty Rd property; a General Security Agreement; guarantees; and a guarantee from the Swan Family Trusts Partnership.

Cynget's experience of swaps

[34] Even before the swap payment commenced the Bank was becoming concerned about the effect of the GFC on its swap products. On 27 May 2008, Mr Dean Edgerton from the Markets team directed team members to call swap clients to give them the opportunity to restructure. He said "the actual call is just as important as the result of the call" because "[h]aving a record of contact on our database with our clients where we have presented an opportunity to shorten will be invaluable if interest rates subsequently fall sharply". Around the end of June 2008 the Bank's economic updates stopped advising against floating rates and were noting increased prospects for a lower OCR.

[35] Payments for the swaps commenced on 20 June 2008. Compared with the floating rates on the underlying loan Cygnet benefited from having the swaps at 8.15% for Swap 1 and 7.95% for Swap 2 until November 2008.

[36] The Swan Family Trusts Partnership guarantee had not been part of the original approval but was required to cover the Bank's risk with the bridging loan. The Swans signed a solicitors' letter that if the guarantee was not released by 1 January 2009, the Cornwall Rd Property would be sold. The Bank was aware of

this.[6] The Swans were concerned about their debt situation because of uncertainty over when all the Bell Block sections would sell. So they began the process of selling the Cornwall Rd farm around the start of June 2008. The National Bank was aware of this by 9 July 2008, at the latest.[7] The sale, on 27 July 2008, realised net proceeds of $2.1 million, substantially more than had previously been expected according to a 2007 valuation by the Bank.

[37] This was when the Swans received their first surprise regarding the effect of the swaps. They asked Mr Fleming about the cost to cancel the swaps because they were selling the farm. Mr Fleming advised there would be a significant break fee to break and repay the swaps. The Swans say he told them it would be $30,000 to $36,000 though he disputes that he quoted those figures. The break fee could either be paid up front or spread over an extended swap by way of an increased interest rate. Rather than breaking the swaps at that point, the Swans used the proceeds to repay the bridging loan and the deposit and GST loan that were part of the Finnerty Rd funding as well as the principal loan from the Bell Block financing and their $60,000 personal loan. Those loans had been intended to be repaid by projected Bell Block sales, which were still to come.

[38] Any future sales would require large break fees. The Swans submit that, at that point, it should have been obvious to the Bank that the swaps were no longer suitable for the Swans.

[39] In July 2008, the head of Interest Rate Risk Management – Rural at the Bank prepared a detailed analysis of rural swaps and stated:

> NZ Swap curve, high in short end, lower in long end. Rate cuts are coming . . . but how low will we go?
>
> Strategy has been to recommend shorter durations since February. We now have approx. 70% of our portfolio 3 years or less.

6 The Bank's rural loan report of 28 May 2008 recorded that "Parents will have a clause if gtee is still required by Jan 09, Cornwall Rd Farm will go on the market". A 28 May 2008 fax from the Bank to a solicitor agreed to release the guarantee in certain circumstances.

7 That is when Mr Fleming asked Mr Esquilant how much cancellation of the swaps would cost because Cygnet could be selling the farm.

[40] In September 2008 Lehmann Brothers, Freddie Mac and Fannie Mae failed in the United States. The GFC was in full swing. The Reserve Bank of New Zealand cut the OCR by 50 basis points on 11 September 2008 and by a further 100 basis points on 23 October 2008. Bill rates and the floating rate paid on the underlying loan dropped precipitately. The floating rate on the loan underlying Swap 2 dropped from 7.57% in November 2008 to 6.51% in December 2008, 5.95% in January 2009 and 4.92% in February 2009. The floating rate on the underlying loan for Swap 2 (including the margin) did not rise above 5%, or (with one month's exception) fall below 4%, for the rest of its term to maturity.

[41] On 28 November 2008 the sale of a Bell Block section settled for $551,840. Mr Swan believes he would have told Mr Fleming about this before June 2008 when the Agreement for Sale and Purchase was signed. Certainly it is clear the Bank knew about it by 17 November 2008 when the Swans' solicitor sought a discharge of the relevant mortgage. After repaying the outstanding loan on the Bell Block properties there would be $200,000 left over. The Swans wanted to retain that. Mr Fleming supported them. But the Bank's credit department required the Swans to pay down $200,000 of core debt – core debt that was subject to the swaps. That required a swap to be broken.

[42] In agreeing to release its mortgage over the Bell Block property the Bank required the $2 million three year swap contract be broken. The break fee was approximately $13,000. The bank allowed the Swans to choose to reduce the swap and pay a break fee up front or extend the swap by a year or by two years. None of these options involved breaking the swap and refinancing using a floating or fixed rate term loan. The Swans were unhappy about the choices they were given. They chose to reduce the swap to $1.8 million at 7.9%, extended for an extra year to June 2012.

[43] The Swans became increasingly concerned about the possibility that the Bank would require them to break the swaps again when further funds became available and that break fees would increase. On 8 January 2009 Mr Swan rang Mr Derek Whittaker from the Markets team to ask how much it would cost to break the swaps.

Mr Whittaker advised the break cost would be $193,000 for the $1.8 million swap and $260,000 for the $1.94 million swap. The conversation went as follows:

> **Craig:** What are we better off to do here, Derek? It seems to be snowballing this, aye. Can we do anything?
>
> **Derek:** Well the out of the money position is the same as if you were in a fixed term loan, or something like that. You would be in exactly the same type of situation. What it is is you have got a, on your June 2012 one, I think we spoke about that, that if you could…just hang on a second, I will just have a look to give you an indication. I am thinking of try and…copy…OK. I will just show you if we did anything to extend that… I'll see if I can illustrate things.
>
> **Craig:** But you know what is happening to us every time we sell some land, industrial land…
>
> **Derek:** Oh.
>
> **Craig:** …the bank is [unintelligible] security you see. See I'm in a different boat that the Joe Average farmer…
>
> **Derek:** Oh, OK. So some of these swaps you're wanting to reduce, is that what you are saying?
>
> **Craig:** Well the bank are making us reduce it and they're using it for secure…and I don't quite want to do that, so I'm looking at saying we'll break it and go onto…
>
> **Derek:** OK, I'm with you. OK.
>
> **Craig:** Can you help us with that or not?
>
> …
>
> **Derek**: Yip, if you definitely believe that you do not need this hedge in place, you are better off the sooner that you break the better.
>
> **Craig**: I can't understand why we didn't get advice on this earlier, you know, or is that just the way it is?
>
> **Derek**: Well, I am certainly not familiar with your situation regarding the…this debt having to be reduced. We don't know anything about that really. Your RM is the best to give you advice on that, so I don't know how long this situation has been…

[44] Six days later, on 14 January 2009, Cygnet broke the $1.8 million swap. By then, the break fee turned out to be $225,488. The Bank agreed to reduce the fee to $218,488 due the Swans' concerns at the Bank's delay in actioning the break that day. In expressing his concerns about this Mr Swan made clear that his concern was

not about the break fee as such, but about the increase in break fee in a matter of hours for reasons he did not regard as legitimate.

[45] Swap 2, for $1.94 million, continued in place. On 31 March 2009 the Bank increased the margin on the loan associated with that swap from 1.2% to 1.38% - increasing the interest costs to Cygnet by $14,753 over the term of the swap. The Bank notes it raised its margins on other lending higher. The margin on Cygnet's other lending reached 3.95% between October 2010 and April 2011. Swap 2 ran to maturity in June 2013 as it was uneconomic to break. Cygnet refinanced its loans with Westpac in July 2013.

[46] By June 2009 the Bank had clearly come to the view that there had been significant problems with its marketing of swaps. The Bank's "self-paced learning module" in June 2009, titled "Managing Interest Rate Swaps and Bills", identified nine significant sets of "current issues". Mr Branch, for Cygnet, says he relies on this document as Bank recognition of conduct that had actually happened.

[47] The "overview of current issues" from Module 1 gives an idea of the conclusions the Bank had come to by then about swaps:

Background	RMs and/or Markets Dealers have not been fully aware of their responsibilities when presenting information and material relating to Interest Rate Swaps. The following overview of issues stems right back to understanding the customer's suitability through to the customer meeting.
Issue 1	Customers are not suitable for the Interest Rate Swap product. Rural Managers and Markets Dealers have allowed unsuitable customers to use Interest Rate Swaps. Customers are not sufficiently financially sophisticated to understand Interest Rate Swaps, and make their own decisions on them, or their financial and credit position is not suitable to Interest Rate Swaps.
Issue 2	The Interest Rate Swap product is not suitable to the customer's needs, such as for rate certainty. Interest Rate Swaps have been used in inappropriate situations such as extended forward starts, and bridging situations. Customers have not been aware of alternatives.

Issue 3 The customer has had an expectation of advice and active management of the Interest Rate Swap on the part of the Markets Dealers, from their sales interactions, and this has not been met.

Issue 4 Incorrect description of the effect of a Bill Loan and associated Interest Rate Swap.

The combination of a Bill Loan and associated Interest Rate Swap has incorrectly been described to customers as being like a fixed loan. Bill Loan credit margins and Interest Rate Swap interest rates have incorrectly been brought together as one customer rate or cost of funds, which is incorrect.

As a result of increases in the Bill Loan credit margins, that reference to the Interest Rate Swap being like a fixed rate loan is not correct.

Issue 5 Customer's Interest Rate Swaps do not reflect their debt structure and loan types.

Mismatches of date and term and over-heading of Bill Loans by Interest Rate Swaps have occurred.

Issue 6 Customers have been given non-standard letters and sale materials by RMs and Markets Dealers, which has not helped customers understand the products they are entering into with the Bank.

Issue 7 RMs and Markets Dealers have made statements to customers, which can be interpreted as misleading, or deceptive, or confusing.

Terminologies such as "swap loan", "swap margin", and "swap rate" have been used. Customers do not understand the Interest Rate Swap product is completely separate to the Bill Loan.

Issue 8 Rural Managers have provided advice on Interest Rate Swaps.

Issue 9 Customers are not clear on the implications of features of Interest Rate Swaps, to them.

For example they do not understand that Interest Rate Swaps may utilise available security and result in an increase in their Bill Loan credit margin, or they do not understand the effect of interest rate movement on their Interest Rate Swap position.

[48] The sample answers to Module 3, about "the Swap product", provided guidance about the RM's role, the Markets Dealer's role, what an interest rate swap

is and who is suitable to enter into a swap. It also includes a list of statements of "what we never say to customers" and guidance on how to manage existing swap customers and swap restructuring.

Commerce Commission settlement agreement

[49] Others also had concerns about the marketing of interest rate swaps to rural customers. On hearing about such concerns Mr Swan raised his concerns with the Bank in August 2012. Cygnet and others then participated in an investigation by the Commerce Commission into the Bank's selling of swap products.

[50] On 3 December 2014 the Bank (as ANZ) entered into a settlement agreement with the Commission. It records:

> 2.6 The Commission has completed the Investigation into ANZ's conduct and concluded that, in its view, there is a sufficient foundation for it to commence proceedings against ANZ alleging breaches of the Act. In particular, the Commission considers that ANZ engaged in conduct that conveyed the impression to existing and potential customers, including Named Customers, that:
>
> (a) Margins on the Loan would not change for the term of the original Swap and for any Restructure, extension, or shortening of the term of the Swap; and/or
>
> (b) The ETA [Early Termination Amount] would be the same or materially similar to the cost of terminating a fixed rate term loan of equivalent amount, interest rate, and duration; and/or
>
> (c) Swaps were a suitable alternative and good substitute for a fixed rate term loan for the circumstances of the customer or potential customer (the **Conduct**).
>
> 2.7 The Commission concluded that the Conduct was, or was likely to be, misleading because:
>
> (a) with respect to Margins, under the contractual terms ANZ could (and, in some instances, did) increase Margins;
>
> (b) with respect to termination, the ETA could be significantly higher than the amount payable to terminate an equivalent fixed rate term loan;
>
> (c) with respect to suitability, Named Customers could not always take advantage of the flexibility of the Swaps because:

(i) doing so attracted a cost that was not foreseen by the Named Customers, which undermined the flexibility of the Swap and dissuaded some Named Customers from exercising that option;

(ii) the Named Customers were not technically equipped to monitor and adjust the Swaps.

2.8 The Commission considers that it is likely that some ANZ rural customers may have suffered loss as a result of the Conduct.

[51] As part of the settlement ANZ agreed not to oppose the High Court making the following declaration:[8]

> Between on or about July 2005, and 31 March 2009, ANZ Bank of New Zealand Ltd breached s 9 of the Fair Trading Act 1986, in that, being in trade, it engaged in conduct that was misleading in relation to some of the customers listed in Schedule 1 to the Statement of Claim, in that it understated some of the risks and/or overstated some of the benefits of interest rate swaps arrangements to those customers.

[52] The Commerce Commission also pleaded that ANZ represented that it would monitor and/or manage swaps to ensure customers were able to take best advantage of the flexibility and benefit of the swaps. ANZ specifically denied it had done that.

[53] ANZ agreed to pay $18.5 million across all the affected parties. Cygnet was offered $83,278 which represented:

(a) 100% of the increases to margins; and

(b) 100% of the estimated difference between the ETA paid on termination (or embedded in a restructured swap) and the break fee that would be otherwise payable on an equivalent fixed rate loan. That estimated difference was calculated at 30% of the value of the ETA (paid or embedded).

[54] Cygnet rejected the offer and has pursued these proceedings instead.

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8 *Commerce Commission v ANZ Bank New Zealand Ltd* [2015] NZHC 1168.

Key factual findings regarding representations

[55] At the root of all but one of the causes of action are six representations Cygnet alleges the Bank made:[9]

(a) The swap product was different from products offered by other banks as the level of service and help that came with the swap product was significant.

(b) If there were any changes in the circumstances which could affect the swaps, there would be notification and advice on what to do.

(c) In response to a query by Mr and Mrs Swan about the downsides of the swap product, that there were no real downsides.

(d) The swap product was the right product for Cygnet as the company would be able to manage the rate being paid.

(e) The swap product would keep the rate the same, like a fixed loan but with upside and flexibility.

(f) The swaps should be entered into before the settlement date for the Finnerty Road property so as to take advantage of the good interest rates available.

[56] In effect these representations relate to downsides to swaps, suitability of swaps, advice and a forward start. At this point it is useful to set out factual findings about those four representations.

1 Like a fixed rate loan but with upside and flexibility

[57] I find that the Bank did represent to Cygnet that swaps were like a fixed rate loan but with upside and flexibility. That was the firm evidence of Mr and Mrs

[9] Second Amended Statement of Claim of 27 June 2016 at [27]. As pleaded, the third of these had additional words "… as, looking back, historically interest rates had always risen". Cygnet conceded at trial that those additional words had not been used.

Swan.[10] In his evidence in chief Mr Fleming agreed Mr Esquilant probably did say something to that effect. Mr Christopher Schurr who attended several presentations by Mr Esquilant (though not that given to the Swans) does not recall Mr Esquilant ever giving any advice about the downsides of swaps at the presentations he attended. Mrs Swan's evidence is that, in reply to her question at the presentation, Mr Esquilant stated there were no real downsides. And Mr Esquliant agreed, under cross-examination, that he considered swaps were "like a fixed rate loan with flexibility and upside".[11]

[58] The undisclosed downsides related to the credit margin, the credit limit and break fees:

(a) *Credit Margin:* It is clear the Bank did not explain to the Swans it could increase the credit margin on the underlying loan when a swap is used, unlike for a fixed rate loan. The Swans say there was no such discussion. Mr Esquilant and Mr Fleming confirm it. Mr Schurr does not recall Mr Esquilant ever saying that the Bank could increase their margins at the presentations he attended. The Bank submits "[t]he most likely conclusion is that Mr Esquilant and Mr Fleming did not specifically explain to the Swans that Cygnet's margin could increase, but nor did they represent that it would not".[12] The Bank's own expert Mr Rankin, agreed a bank is not able to increase the margin on a fixed rate loan unless it goes to the extreme step of calling up or reviewing the loan.[13]

(b) *The Credit Limit or Market Replacement Risk (MRR)* was the Bank's additional credit limit for swap customers. In an internal amendment of 20 December 2007 to its original approval the Bank initially approved a MRR of $300,000 for Cygnet to cover potential exposure from the swaps.[14] The MRR impacted on the Bank's assessment of

10 Brief of Evidence of Craig Swan at [42].
11 Notes of Evidence at 251/27-29.
12 Defendant's Closing Submissions at [106].
13 Notes of Evidence at 320.
14 Brief of Evidence of Haydon Dillon at [33].

Cygnet's credit rating. The Bank's training material from 2005 indicated it was a "hard limit" though the position in practice appeared a bit more fluid, at least until the GFC began to bite.[15] Mr Fleming's evidence under cross-examination was that the MRR bit Cygnet when it was selling its sections and the Bank required the funds to repay debt.[16] He also acknowledged it appeared that, by March 2012, removal of the MRR limit could reduce Cygnet's margin by 0.6 of a percentage point.[17] No MRR is applied for a normal fixed rate loan.

(c) Mr Esquilant says he "would have" explained the requirement for the credit limit, or MRR, to the Swans though he agrees he would not have taken them through how it was calculated. In his evidence in chief Mr Fleming was sure that he did.[18] But, under cross-examination he was unable to confirm that it was and hoped Mr Kelly had done so.[19] Mr and Mrs Swan both say it was not. It is something they could be expected to have recalled. The reference to the MRR that had been in a previous version of the brochure was not in the version left with the Swans.[20] There was no documentation of any such discussion or even communication of the MRR to Cygnet. I find that the existence, nature and function of the credit limit on the interest rate swap was not explained to the Swans. There is certainly no evidence the Swans agreed to an MRR, as another version of the Bank's brochure about swaps said was required.

(d) *Break fees:* The brochure outlined the break fees and the dependence of the break fees on the current market value of the swap. It also contained a worked example. The Bank says that "in broad terms" the break fee for a swap was the same as for a fixed rate loan. As Mr Rankin explained, the difference is that the break fee on a fixed rate

15 Notes of Evidence 262/10 – 263/20 and 271/26-33.
16 Notes of Evidence 265/6-9.
17 Notes of Evidence 273/26 – 274/13.
18 Brief of Evidence of Michael Fleming at [32].
19 Notes of Evidence 275/25 – 277/6.
20 Notes of Evidence 167/1-20 and 179/16-26.

loan is not affected by changes to the margin whereas it is for a swap.[21] The difference is a function of the Bank's own cost of funds which would not be expected to change in ordinary circumstances. But the Bank accepts Mr Esquilant did not explain that the break cost methodology was different to that under fixed rate loans. The Swans say the same. I find accordingly.

2 Suitability

[59] There is no evidence the Bank made a representation that Cygnet would be able to manage the rate being paid. A bank can't predict what a customer will or will not be able to manage by way of repayments in all future circumstances. It lends on the basis of a risk assessment that may or may not turn out to be justified.

[60] But I do find the Bank represented an interest rate swap to be a suitable product for Cygnet. This was implicit in the Bank offering to make a presentation to the Swans about swaps, making the presentation and then facilitating entry into the swaps. Mr Esquilant's evidence was that if a customer had $5 million it must have possessed the necessary sophistication or nous to be suitable for a swap. The Bank submits "Mr Esquilant and Mr Fleming regarded swaps as a good product which would allow Cygnet to fix its base interest rate exposure."[22] It also submits "[g]iven the interest rate environment at the time, Cygnet's projected tight cashflow, and the lack of any indication that Cygnet would repay the core debt within the term of the swaps, the swaps *were* an appropriate product for Cygnet".[23]

[61] I also find there was no discussion by the Bank about whether the Swans were likely to want to repay any of the loan that would be subject to the swaps. Mr and Mrs Swan say Mr Fleming did not have such a discussion with them. Mr Fleming says he and Mr Esquilant "would have" discussed that if they had talked about it – if the topic had come up. But Mr Fleming accepted that he could not dispute the Swan's evidence that he did not ask them about their long term funding

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21 Brief of Evidence of Derek Rankin at [82] - [83].
22 Defendant's Closing Submissions at [103].
23 At [104].

arrangements.[24] And there is no evidence from Mr Kelly who substituted for Mr Fleming when the loan approval was given in November 2007. If any serious such discussion had occurred it could be expected to have been documented. The only relevant documentation was an email from the Swans to Mr Fleming on 30 October 2007 which indicated they intended not to rush section sales and would allow a two year timeframe. Mr Kelly and Mr Fleming may each have presumed the other had had such a discussion.

3 Proactive advice

[62] Cygnet says the Bank represented it would provide a significant level of service and help to Cygnet and that if there were any changes in circumstances which could affect the swaps, there would be notification and advice on what to do. The Bank agrees that something like the first representation was made. It disputes the scope of the second representation but agrees Mr Esquilant said he would be available to discuss options and that he and his team would contact Cygnet if they became aware of any suitable opportunities to manage the swaps.

[63] I agree with both parties that Mr Esquilant did represent to Cygnet that the Bank would provide significant service and help that other banks did not offer. Mr Fleming accepted that in his evidence in chief. I also find the service, help and advice was represented to relate to managing the risks and opportunities of Cygnet's swaps and would be provided proactively. That is because:

(a) That was the Swans' firm understanding.[25]

(b) Of the five "Swaps Key points" on the brochure left with the Swans, number four was "[p]osition will be monitored by a treasury specialist who will provide ongoing advice".

(c) In his evidence in chief Mr Esquilant stated that, on behalf of the Bank, he would "advise customers about the options available at any time", he gave his number to customers and said they could call him if

[24] Notes of Evidence 275/20-24.
[25] Brief of Evidence of Craig Swan at [41]-[44], and Brief of Evidence of Lisa Swan at [17].

there were any issues.[26] Under cross-examination he said he "would have been surprised if he had gone so far as to say the bank would "manage" the customer's interest rate risk.[27] But Mr Esquilant has an enthusiastic personality. Under cross-examination he was particularly unclear about the point, offering and then agreeing at several points that it was "something that may have been implied",[28] while alternately drawing back from it and disputing the definition of "manage".[29]

(d) Under cross-examination Mr Fleming was unsure about whether Mr Esquilant and his team were required to keep an eye on whether the customer should break a swap or not.[30] Mr Fleming's evidence in chief was that:[31]

> [Mr Esquilant] would have made the point that there was a dedicated Markets team who would be available to talk to them in relation to their swaps and who would also be thinking about possible opportunities for them in relation to their swaps and presenting them from time to time.

And:

> [Mr Esquilant] and the rest of the team were in fact always working behind the scenes in 2008 and 2009 to try and identify opportunities for swaps customers to actively manage their swaps to their advantage.

[64] In its 2009 training presentation, the Bank stated an explanation of a derivative product became investment advice if:

> No, if you merely provide factual information about the product, or explain how the product works.
>
> Yes, if you explain how:
>
> - the derivative suits a particular investor/class of investors.

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26 Brief of Evidence of Stuart Esquilant at 35.
27 Notes of Evidence 194/20-23.
28 Notes of Evidence 194/20-21, 194/30, 195/13.196/4-9.
29 Notes of Evidence 194/20 to 196/9.
30 Notes of Evidence 261/10 - 261/23.
31 Brief of Evidence of Michael Fleming at [30(b)].

- compare derivatives to other investments and/or recommend one over the other.

[65] That is what the Bank did. It went beyond "the normal recommendations . . . given in the daily interactions between an institution's salesforce and a purchaser of its products".[32] It represented it would give advice.

4 Forward start

[66] Finally I agree that the Bank represented, in Mr Esquilant's telephone conversation with Mrs Swan on 25 January 2008, that the swaps should be entered into before settlement of the Finnerty Road property to take advantage of the interest rates available. That is evident from the transcript of the telephone conversation quoted above.

The laws of misrepresentation

Five causes of action

[67] Cygnet pleads five causes of action, in tort law, contract law and under the Fair Trading Act 1986. In summary, Cygnet claims:

(a) the Bank was negligent in making representations to Cygnet because it breached its duties to take reasonable care to ensure a proffered explanation is accurate, a reply to an inquiry is honest and correct, and to ensure sufficient advice was given to make a fully informed decision and in making recommendations;

(b) the Bank made negligent misstatements in making its representations because it gave advice calling for special skill and competence on which Cygnet relied and it failed to exercise reasonable care to ensure its representations were accurate;

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[32] *Thornbridge Ltd v Barclays Bank Plc* [2015] EWHC 3430 (QB) at [70].

(c) the Bank made pre-contractual misrepresentations, under s 6 of the Contractual Remedies Act 1979, that induced Cygnet to enter into the swaps and suffer loss;

(d) the Bank had a partly oral contract, or alternatively a collateral contract, regarding the level of service it would provide to Cygnet, which it breached causing Cygnet loss;

(e) the Bank's representations were misleading and deceptive in terms of s 9 of the Fair Trading Act, which misled Cygnet and caused it loss.

[68] Each of these five causes of action uses a different area of law to get at the same thing – liability for misrepresentations. There is little dispute between the parties over the nature of all but one of these areas of law. The exception is whether the tort of "pure" negligence, as Chambers J characterised it,[33] can impose liability on the Bank arising from its relationship with Cygnet. The Bank opposes the imposition of what it says would be a novel general duty of care on banks under that heading.

[69] In this part of the judgment I outline the elements of each of the laws of representation which are similar to, but different from, each other. I then summarise how I apply the laws of misrepresentation to the facts in terms of six issues.

The law of negligence

[70] The law of tort imposes liability for negligence on those who breach a duty of care owed to others, causing loss. In New Zealand, the Supreme Court in *North Shore City Council v Attorney-General (The Grange)* stated the approach of New Zealand courts in deciding whether a duty of care is owed.[34] I summarise the approach as analysing:

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[33] *Body Corporate No 207624 v North Shore City Council* [2012] NZSC 83, [2013] 2 NZLR 297 at [220] [*Spencer on Byron*].

[34] *North Shore City Council v Attorney-General* [2012] NZSC 49, [2012] 3 NZLR 341 [*The Grange*] at [149]-[161]. The Court applied the same approach in *Spencer on Byron* and again in its recent judgment in *Carter Holt Harvey Ltd v Minister of Education* [2016] NZSC 95 at [14].

(a) First, whether everything bearing on the relationship between the parties, including its factual and policy aspects, establishes a prima facie duty of care, particularly:

(i) that the loss was reasonably foreseeable; and

(ii) that there is sufficient proximity in the relationship – that the closeness of the connection between the parties means the defendant is most appropriately placed to take care to avoid the damage (including whether liability will create disproportion between the defendant's carelessness and the actual form of loss suffered); and

(b) second, whether or not it is fair, just and reasonable to impose a duty of care, having regard to policy considerations concerned not with the relationship between the parties but with the effect of recognising a duty of care on other legal obligations, the legal system and society more generally (including the relative capacities of the parties to insure and the incentive effects).

[71] The Supreme Court endorsed Lord Cooke's precept that such an approach "is only a framework", the formulation of which "should not matter in the end" since "[f]ormulae can help to organise thinking but they cannot provide answers".[35] In other words, "this approach is a framework, rather than a straitjacket".[36] The point of the inquiry can be summarised as being to determine whether it is fair, just and reasonable for the law to impose a duty of care in negligence on the parties.[37]

[72] I note that contractual documentation, including exclusion clauses, can be relevant to whether there is a prima facie duty. But they are not necessarily determinative. In *Carter Holt Harvey Ltd v Ministry of Education* the Supreme

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35 At [149] and [161] (per Blanchard, McGrath and William Young JJ) and at [26] (per Elias CJ), citing *South Pacific Manufacturing Co Ltd v New Zealand Security Consultants & Investigations Ltd* [1992] 2 NZLR 282 (CA) at 294(i). The Court further reiterated this point in *Spencer on Byron,* above n 33, at [184].

36 *Carter Holt Harvey Ltd v Minister of Education,* above n 34, at [14].

37 For example *Carter Holt Harvey Ltd v Minister of Education,* above n 34, at [14].

Court considered, at a preliminary strike-out stage, contractual terms of supply between Carter Holt and merchants and between the merchants and building contractors. It concluded the terms ("particularly if they are standard form contracts") were likely to be different from "the carefully calibrated contractual regime" in *Rolls-Royce* which was specifically designed for the particular project, where the parties were legally advised throughout and chose how the risks and responsibilities would be allocated.[38]

[73] In relation to banking generally, as *Ellinger's Modern Banking Law* states, "a bank does not ordinarily owe its customers any general duty to furnish careful advice on business or banking transactions, unless such advice is specifically requested and the bank specifically undertakes to provide it".[39] The Bank here emphasises that point and submits there is no basis to develop the law of negligence to impose a general duty of care on banks.

[74] But that is not the right question. Rather the question is whether it is fair, just and reasonable for the law to impose a duty of care in negligence on the basis of the particular relationship between the parties here, who are a bank and a customer in rural New Zealand, entering an interest rate swap agreement. That question must be addressed on the basis of "the detailed circumstances of the particular case and the particular relationship between the parties in the context of their legal and factual situation as a whole", in Lord Bingham's words.[40]

[75] If a duty is established in law, then liability in tort follows if the duty is breached, causing loss. Damages can usually then be awarded to restore the plaintiff to the position where the tort, the misrepresentation, had not occurred. Notably in this case however, as discussed below, section 6(1)(b) of the Contractual Remedies Act 1979 limits the Court's ability to award damages for negligence in respect of a misrepresentation which has induced a party to enter a contract.

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38 *Carter Holt Harvey Ltd v Ministry of Education,* above n 34, at [26].

39 E P Ellinger, E Lomnicka, C V M Hare *Ellinger's Modern Banking Law* (5th ed, Oxford University Press, Oxford, 2011) at 162.

40 *Customs and Excise v Barclays Bank plc* [2006] UKHL 28, [2007] 1 AC 181 at [8].

The law of negligent misstatement

[76] In the course of developing its approach to the law of negligence the House of Lords identified, in *Hedley Byrne & Co Ltd v Heller & Partners Ltd,* a duty of care in tort, on bankers, not to make negligent misstatements.[41] This case was one of the foundations of the more generic approach.

[77] I consider negligent misstatement is simply an example of a duty of a care imposed by the law of negligence on particular relationships involving statements by one party to another. Conceptually, such a duty fits within the general law of negligence and is encompassed by the Supreme Court's framework in *The Grange*. Other sorts of statements may also attract the imposition of a duty of care by the law of negligence in the right circumstances using that framework. But the elements of the duty not to make a negligent misstatement are now well-established.

[78] In *Carter Holt Harvey v Minister of Education* the Supreme Court recently cited the summary by the majority in *The Grange* of the requirements that must "typically" be met before a plaintiff can say it is entitled to rely on a statement or advice:[42]

> The necessary relationship between the maker of the statement and the recipient will typically arise where:[43]
>
> (a) the advice is required for a purpose that is made known (at least inferentially) to the adviser;
>
> (b) the adviser knows (at least inferentially) that the advice will be communicated to the advisee specifically or as a member of an ascertainable class;
>
> (c) the adviser knows (at least inferentially) the advice is likely to be acted on without independent inquiry; and
>
> (d) the advisee does act on the advice to its detriment.

[79] I note three points about the elements of negligent misstatement:

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41 *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465.

42 *Carter Holt Harvey Ltd v Minister of Education,* above n 34, at [80].

43 *The Grange*, above n 34, at [189]; citing *Caparo Industries PLC v Dickman* [1990] 2 AC 605 (HL) at 638.

(a) The nature of the relationship in all its aspects must be examined in determining whether there is a prima facie duty.

(b) Negligent misstatement cases usually proceed on the basis that the plaintiff is required to have reasonably relied on the defendant. Whether or not that is necessarily required,[44] the question of whether there was reliance is fact dependent and goes to causation in negligent misstatement cases anyway.[45] As such it is one obviously relevant and potentially important consideration in relation to misstatements.

(c) Chambers and McGrath JJ in the Supreme Court stated in *Spencer on Byron* that, if a defendant owes a duty of care in pure negligence, a negligent misstatement cause of action may add nothing but may just put an additional hurdle in the plaintiff's way (establishing reliance, if that is an additional requirement).[46]

[80] As with pure negligence, if the duty of negligent misstatement is breached, causing loss, then damages in tort usually follow, putting the plaintiff in the position had the misrepresentation not been made. Again, the availability of damages is limited by the Contractual Remedies Act.

Misrepresentation and damages in contract law

[81] Before 1979 there were different sorts of misrepresentation. A party could rescind a contract for an innocent pre-contractual misrepresentation but could not get damages, as it could for fraudulent misrepresentation. Section 6 of the Contractual Remedies Act 1979 simplified the law by providing for damages for pre-contractual misrepresentations. It states:

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44 The Supreme Court in *Carter Holt Harvey,* above n 34, at [85] appears to have left for future determination whether proof of actual reliance is necessarily required.

45 As noted by Tipping J in *Spencer on Byron,* above n 33, at [34].

46 *Spencer on Byron,* above n 33, at [220] and [223] (Chambers and McGrath JJ) and see *Carter Holt Harvey,* above n 34, at [85].

6 Damages for misrepresentation

(1) If a party to a contract has been induced to enter into it by a misrepresentation, whether innocent or fraudulent, made to him by or on behalf of another party to that contract—

(a) he shall be entitled to damages from that other party in the same manner and to the same extent as if the representation were a term of the contract that has been broken; and

(b) he shall not, in the case of a fraudulent misrepresentation, or of an innocent misrepresentation made negligently, be entitled to damages from that other party for deceit or negligence in respect of that misrepresentation.

[82] Liability for pre-contractual misrepresentation requires there to be a misrepresentation which induced the plaintiff to enter the contract. The requirement that there be a misrepresentation is similar to the requirement of a misstatement in negligent misstatement (or in negligence, breach of a duty not to make misrepresentations). The requirement for inducement to enter the contract is similar in substance to the requirement of reliance in negligent misstatement (or in negligence, at least in terms of causation of loss).

[83] The courts have held, regarding pre-contractual misrepresentations, that the representation must be understood as a reasonable person would understand it, must be false, and must have been intended to induce entry into the contract so must be material.[47] A representation of a future intention, rather than an existing or past fact, is not an actionable misrepresentation.[48] But the boundaries between those states can blur since a representation of future intention may imply a representation that the intention exists or may imply a representation about another existing fact.[49]

[47] John Burrows, Jeremy Finn, Stephen Todd *Burrows, Finn and Todd Law of Contract in New Zealand* (5th ed, LexisNexis NZ Limited, Wellington, 2016) at 363-367 [*Burrows, Finn & Todd*].

[48] *Burrows, Finn & Todd,* above n 47, at 353-354. And see Francis Dawson and David W McLauchlan *The Contractual Remedies Act 1979* (Sweet & Maxwell (NZ) Ltd, Auckland 1981) [Dawson and McLauchlan].

[49] *Burrows, Finn & Todd,* above n 37 at 353-354 citing *Edgington v Fitzmaurice* (1885) 29 Ch D 459 and *New Zealand Motor Bodies Ltd v Emslie* [1985] 2 NZLR 569 (HC).

Alternatively, it is possible for a court to find there is an implied term in a contract that would be breached by a misrepresentation.

[84] While the Act provided for damages for misrepresentation it also sought to allow parties to agree on their own remedy, by contract. So s 5 provides:

> **5 Remedy provided in contract**
>
> If a contract expressly provides for a remedy in respect of misrepresentation or repudiation or breach of contract or makes express provision for any of the other matters to which sections 6 to 10 relate, those sections shall have effect subject to that provision.

[85] This says a clause in a contract expressly providing for a remedy for misrepresentation, or for any of the other matters to which s 6 relates, overrides the availability of damages for misrepresentation in s 6.

[86] There has been academic questioning of the effectiveness of this clause. As Professors Dawson and McLauchlan point out, a literal interpretation of the words of s 5 do not catch exclusion clauses because exclusion clauses do not provide a "remedy" or provide for any of the other matters to which s 6 relates.[50] They also acknowledge that Parliament's purpose was not to alter the common law on exception clauses, which allows parties to contract out of responsibility for misrepresentations. As Mr Thompson MP said in the second reading debate on the Bill "it is desired to continue to provide that, as a general rule, parties to a contract should be able to designate or limit the remedies for breach of contract" but "there is no contracting out with impunity".[51] Dawson and McLauchlan give a hypothetical example of a clause, similar to one at issue in this case, which says:[52]

> Although I made certain representations to you which you may have relied upon, you do so at your own risk. I do not accept legal liability for the accuracy of the representations.

[87] They say that if s 5 is interpreted literally that clause is ineffective, since it does not provide for a remedy or other matters to which s 6 relates. But the courts

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[50] Dawson and McLauchlan, above n 48, at 184-188
[51] (12 June 1979) 422 NZPD 627.
[52] Dawson and McLauchlan, above n 48. at 186.

interpret legislation in light of the purpose of Parliament in enacting it.[53] And, despite subsequent criticism,[54] the Court of Appeal did not have much difficulty in doing so in 1997 in *The McKenzie Institute International v Accident Rehabilitation and Compensation Insurance Corporation.*[55] Dawson and McLauchlan say "if s 5 is interpreted in accordance with the intention of Parliament, such a clause will be effective (subject to the usual rules of interpretation) to exclude liability under s 6 and it will also be immune from possible attack under s 4".[56] There appears to be no Supreme Court authority on exclusion clauses and the Act, yet.

[88] Section 4(1) of the Act provides the courts with flexibility in applying some sorts of exclusionary clauses. It provides:

> **4 Statements during negotiations for a contract**
>
> (1) If a contract, or any other document, contains a provision purporting to preclude a court from inquiring into or determining the question—
>
> (a) whether a statement, promise, or undertaking was made or given, either in words or by conduct, in connection with or in the course of negotiations leading to the making of the contract; or
>
> (b) whether, if it was so made or given, it constituted a representation or a term of the contract; or
>
> (c) whether, if it was a representation, it was relied on—
>
> the court shall not, in any proceedings in relation to the contract, be precluded by that provision from inquiring into and determining any such question unless the court considers that it is fair and reasonable that the provision should be conclusive between the parties, having regard to all the circumstances of the case, including the subject matter and value of the transaction, the respective bargaining strengths of the parties, and the question whether any party was represented or advised by a solicitor at the time of the negotiations or at any other relevant time.

[89] The Court of Appeal has said this is a wide judicial discretion and its purpose is "to protect one party's relative vulnerability from another party's power to impose

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53 Interpretation Act 1999, s 5.

54 D W McLauchlan "Excluding Liability for Misrepresentation: A Not So Plain Exclusion?" (1998) NZBLQ 59 at 59. See also Brian Coote "The Continuing Problem of Section 5, Contractual Remedies Act 1979 (1998) NZBLQ 124.

55 *The McKenzie Institute International v Accident Rehabilitation and Compensation Insurance Corporation* (1997) 8 TCLR 329 (CA).

56 Dawson and McLauchlan, above n 48 at 186.

an exemption from liability which is contrary to the factual reality or an existing legal obligation and is thus unreasonable and unfair".[57] So I am not precluded, by a clause referred to in s 4(1), from determining a pre-contractual statement was a representation and was relied upon unless I consider it is fair and reasonable that the provision "should be conclusive between the parties, having regard to all the circumstances of the case".

[90] But, as the Bank submits and Dawson and McLauchlan recognise, s 4(1) does not reach contractual exclusions of liability which must be given effect. Although potentially anomalous, s 4(1) "enables a court to disregard (or give effect to) a clause saying 'there are no misrepresentations' but *not* one saying 'no liability for representations'".[58] And, in contract law, a term or condition that is unsigned binds a party who is given reasonably sufficient notice of it before the contract is made but terms and conditions of a signed contract are simply part of the contract.[59]

[91] Accordingly, the effect of exclusion clauses on obligations under contract law is similar to, but different than, their effect on obligations under the law of torts. Contract law requires analysis of whether an exclusion clause is a term of the contract that was agreed between the parties, and interpretation of what the clause means. Tort law requires analysis of whether an exclusion clause is a reason for the law not to impose a duty of care on the parties on the basis of their relationship.

The Contractual Remedies Act and damages in tort

[92] The purpose of damages for breach of civil obligations "is to put the party whose rights have been violated in the same position, so far as money can do so, as if his [or her] rights had been observed."[60] In relation to misrepresentations damages in tort, for negligence or negligent misstatement, restore the plaintiff to the position where the misrepresentation had not occurred.[61] Damages in contract restore the

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57 *PAE (New Zealand) Ltd v Brosnahan* (2009) 10 TCLR 626 (CA) at [15].

58 Dawson and McLauchlan, above 48, at 38.

59 *BBX Financial Solutions Pty Ltd v Trade Management (2010) Pty Ltd (in liq)* [2011] NZCA 667 at [44]-[49].

60 *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd* [1949] 2 KB 528, 539 per Asquith LJ quoted by Dawson and McLauchlan, above n 48, at 26-27.

61 *Livingstone v The Rawyards Coal Co* (1880) 5 App Cas 25 (HL) at 39; *Attorney-General v Geothermal Produce New Zealand Ltd* [1987] 2 NZLR 348 (CA).

plaintiff to the position where the contract is performed on the basis the misrepresentation is true.[62]

[93] The effect of s 6(1) of the Contractual Remedies Act is to provide that a plaintiff can only obtain the contractual measure of damages.[63] Section 6(1) does not say that damages in tort are available if damages in contract are not. It says that if a party to a contract is induced to enter the contract by a misrepresentation by another party then there are two independent consequences:[64]

(a) the induced party is entitled to contractual damages as if the representation were a term of the contract; and

(b) the induced party is not entitled to damages for negligence in respect of a misrepresentation made negligently.

[94] The same restrictions do not apply to agents of the inducing party, from whom damages may be recovered in tort. As between the parties to the contract, however, where s 6(1) applies, contractual damages may or may not be available but damages in tort are not available in either case.

[95] The purpose of this provision was evidently to ensure that the law of contract governs damages for misrepresentation between parties to a contract and that the law of torts does not. As the Contracts and Commercial Law Reform stated in its 1978 report to the Minister of Justice, "[t]he damages will thus be ascertained in accordance with the law of contract and not with the law of tort".[65]

[96] As Professor McLauchlan stated in the year of the Act's passage:[66]

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62 *Burrows, Finn & Todd* above n 47, at 11.2.6.

63 See generally D W McLauchlan "Assessment of Damages for Misrepresentations Inducing Contracts" (1987) 6 Otago L Rev 370.

64 I have considered whether paragraph (b) could be said not to apply if damages in contract, are completely unavailable but the text of the section, and Parliament's purpose in enacting it, means that would strain the provision too much.

65 Contracts and Commercial Law Reform Committee *Misrepresentation and Breach of Contract* (incorporating further report presented January 1978 and Draft Contractual Remedies Bill) at 7. The quoted statement was repeated exactly in the Explanatory Note to the Contractual Remedies Bill as introduced.

66 D. W. McLauchlan *New Remedies for New Contracts* (paper presented to the New Zealand Law Society, 1979) at [2].

> …the common law actions for damages in respect of pre-contract fraudulent and negligent misrepresentation are abolished: s 6(1)(b). These complementary measures were seen as essential if the objective of simplifying the law by providing a common set of remedies for misrepresentation and breach of contract were to be fully implemented.

[97] In 1981 Professors Dawson and McLauchlan stated of the legislative history:[67]

> Neither of the reports of the Contracts and Commercial Law Reform Committee includes a discussion of the implications of making the "contract" rules applicable to all damages actions in respect of pre-contract representations. The 1967 report simply records that:[68]
>
>> "if there is to be a common set of remedies for misrepresentation inducing the making of a contract and for breach of terms of the contract . . . it will be necessary to provide specifically that the measure of damages should be the same – namely that at present provided for breach of a contractual term."
>
> More recently the Committee has stated that the contract measure was chosen because "where a contract supervenes, it is more consonant with justice than the tort measure".[69]
>
> The adoption in s 6 of the contract measure means that plaintiffs will often recover greater damages than they could have in tort under the pre-Act law. However, it is important to realise also that there are situations where the application of the tort measure or the tort test for remoteness of damage are more favourable from the plaintiff's point of view. *In these situations, s 6 will result, assuming established principles of damages law are adhered to, in plaintiffs being deprived of all or part of the damages which they were previously entitled to.*

[98] This is such a case. It may seem more anomalous now that negligent misstatement is firmly established, and the realm of tort has a more expansionary aspect, than it in 1967 when the implications of *Hedley Byrne & Co* were considered to be "not at all developed" by the Contracts and Commercial Law Reform Committee. The Committee stated, "concerned as we are with the field of contract, we incline to the view that negligence is irrelevant".[70] The 1967 Committee was trapped in a contractual perspective stating, in relation to other aspects of negligence, "[o]ur view is that the development of the concept of negligence should proceed as

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67 Dawson and McLauchlan, above n 48, at 26 (explanatory, but not citatory, footnotes omitted and emphasis added). See also McLauchlan, above n 63, at 375-378.

68 Contracts and Commercial Law Reform Committee *Misrepresentation and Breach of Contract,* March 1967 (Government Printer, Wellington, 1969) at [15.1].

69 Memorandum to the Statutes Revision Committee, 30 April 1979 at [7.9].

70 Contracts and Commercial Law Reform Committee, above n 67, at 12 and 17.

part of the law of tort, and that the law of contract should be kept strictly to its function of allocating responsibility according to agreement".[71] As Christine French (as she then was) wrote in 1983 "[t]he tort action was seen as an interloper amongst fundamental contract principles".[72]

[99] The Committee revived its report and accompanied it with a draft bill in 1978. Parliament passed the Bill with minor amendments by the Statutes Revision Committee and little debate the following year.[73] In moving the report-back by the Statutes Revision Committee, Mr Barry Brill recorded "the committee believes that little, if any, additional disincentive arises from the existence of an action in tort".[74] In the second reading debate the Minister of Justice, the Hon J K McLay, stated:[75]

> Clause 6 has been amended by the committee to make it clear that when a misrepresentation of whatever kind induces a contract, the aggrieved party must sue in contract. It was suggested that the right to sue in tort if the misrepresentation is fraudulent or negligent should be retained, because occasionally a tort action might result in a higher award of damages. Equally, however, the damages might be lower. After considering the views of the Law Reform Committee, whose representatives appears before the select committee, the Statutes Revision Committee came to the conclusion that if a contract had been induced by a misrepresentation it was essential to have a single test to measure the quantum of damages. The committee concluded that the test under the law of contract should be preferred.

[100] The outcome of this case illustrates that the effect of s 6(1)(b) can be to remove the ability of plaintiffs to recover meaningful relief under the law of tort even when liability in tort is established and liability in contract is not. Academic commentary has focused on the distinctions between the tort and contract measures of damages in relation to misrepresentation and s 6 but does not appear to have identified its potential disconnection of liability from the remedy of damages. But it is clear law, so I apply it. Reform is up to Parliament.

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71 At 35.

72 Christine French "The Contract/Tort Dilemma" (1983) Otago L Rev 236 at 284.

73 The Statutes Revision Committee made two amendments to what became s 6, adding "to that contract" to the end of the chapeau of s 6(1) and replacing the last word of s 6(2), "contract", with "misrepresentation".

74 (23 May 1979) 422 NZPD 77.

75 (12 June 1979) 422 NZPD 625.

The Fair Trading Act 1986

[101] Another statutory reform, the Fair Trading Act, can provide another avenue for liability for misrepresentations which may be a little wider than the Contractual Remedies Act in some circumstances. Section 9 of the Fair Trading Act provides "[n]o person shall, in trade, engage in conduct that is misleading or deceptive or is likely to mislead or deceive". This includes misrepresentations.

[102] The leading judgment of the Supreme Court in *Red Eagle Corporation Ltd v Ellis* states s 9 "is directed to promoting fair dealing in trade by proscribing conduct which, examined objectively, is deceptive or misleading in the particular circumstances" and the Court makes clear:[76]

(a) "In trade" is "a broad term encompassing all kinds of commercial dealing by the party whose conduct is under examination". It is not an issue here.

(b) The test for misleading or deceptive conduct is objective. Would a reasonable person in the claimant's situation, with the characteristics of which the defendant was or ought to have been aware, have been likely to have been misled or deceived? Intention to mislead or deceive does not have to be shown. Neither must it be proved the defendant was actually misled or deceived.

(c) Context is crucial, including the circumstances in which the conduct occurred and "the characteristics of the person or persons said to be affected". The Court distinguished between a sophisticated businessman, a consumer and someone with intellectual difficulties.

[103] Section 43 of the Fair Trading Act provides, where a court finds a person has suffered loss or damage by contravention of s 9, the Court may make a number of orders for redress. The Supreme Court in *Red Eagle* stated a court "must first ask itself whether the particular claimant was actually misled or deceived by the

[76] *Red Eagle Corporation Ltd v Ellis* [2010] NZSC 20, [2010] 2 NZLR 492 at [28] and footnote 13.

defendant's conduct" and then "whether the defendant's conduct in breach of s 9 was an operating cause of the claimant's loss".[77] Alternatively, the Court said, the breach must be an effective cause, not the sole cause or immaterial to the suffering of the loss. This is similar to the reliance, and causation, required under the Contractual Remedies Act. Amongst the relief available is, under s 43(2)(d), an order to pay the amount of loss or damage.

[104] In relation to damages, the Court of Appeal has treated a misrepresentation which breaches the Fair Trading Act as more similar to the rationale behind damages in tort than in contract: damages will reflect the losses flowing from the misrepresentation.[78] So the position is restored to that which would have been if the misrepresentation had not been made.[79] However, the remedy is discretionary and is "a matter of doing justice to the parties in the circumstances of the particular case and in terms of the policy of the Act".[80]

Applying the laws of misrepresentation

[105] In applying the laws of misrepresentation here I consider the best structure is:

(a) First, examine the effect of the exclusion clauses and whether there was a collateral contract.

(b) Second, examine whether there is sufficient proximity between the parties for the law of torts to impose a duty of care in negligence.

(c) Third, examine whether the Bank made misrepresentations and whether the Bank breached its duties in negligence and negligent misstatement.

(d) Fourth, examine whether the misrepresentations were relied on for the purposes of negligent misstatement, or induced entry into the contract for the purposes of contract law.

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77 At [29].

78 *Cox & Coxon Ltd v Leipst* [1999] 2 NZLR 15 (CA).

79 At 26 (per Henry & Blanchard JJ and, at 23 per Gault J.

80 *Red Eagle,* above n 76, at [31] citing Richardson J in *Goldsbro v Walker* [1993] 1 NZLR 394.

(e) Fifth, examine whether the Fair Trading Act claim was out of time.

(f) Finally, analyse the causation of loss and whether damages should be awarded.

Issue 1: What was the contract?

[106] Under the law of contract there is no impediment to parties to a contract agreeing to exclude liability. What was the effect of the exclusion clauses? Were the representations in a collateral contract?

The exclusion clauses

[107] The Bank's email of 19 December 2007, two days after the presentation, contained a letter that stated:

> 4. Please note that the Terms and Conditions contain a number of important statements about the risks inherent in the transactions you may enter into and the basis on which you and we enter into those transactions.
>
> 5. The Terms and Conditions are important and form the basis on which we conduct transactions with you. Please ensure that you retain them. If you have any questions please contact me on [phone number], or your relationship manager.

[108] The accompanying form the Swans were asked to sign, and did sign on 26 December 2007, was an Institutional Financial Markets Authority that required their financial details and authorised signatures for settlement. Above the signature line is a statement "the Customer confirms the above information is correct and agrees to be bound by the terms of this Authority". A clause on the third page of the authority contains a sentence that "[a]ll foreign exchange and derivative transactions entered into between the Customer and the Bank will be governed by, and subject to the Bank's Terms and Conditions of Institutional Financial Market Transactions" unless two circumstances apply that are not relevant here. The 22 closely typed pages of Terms and Conditions which were attached included these clauses:

> **4.1 Representations and warranties of the Customer:** Unless otherwise expressly agreed in writing by the Bank, the Customer represents and warrants… that:

Full disclosure: all information provided by it to the Bank at any time in connection with the Transaction, the Agreement or any Support Document to which it is a party was true and accurate in all material respects and not misleading as at the date on which it was provided (whether by the omission of facts known to it or otherwise).

…

10.1 **Independent Advice**: The Customer has entered into and will enter into each Transaction and the Agreement in reliance on such independent advice (including tax, legal and financial advice) as the Customer considers necessary and not on any representation or information made or given by the Bank. To the maximum extent permissible by law, the Bank will not be liable for the Customer's loss in any circumstances.

10.2 **Assessment:** The Customer represents and warrants on entering into each Transaction and the Agreement that it:

(a) is capable of assessing the merits of and understanding)on its own behalf or through independent expert advice) and understands, accepts and assumes the terms and conditions and risks of that Transaction and the Agreement.

(b) is satisfied that the Transaction is suitable for its objectives, financial situation and needs; and

(c) understands foreign exchange and derivatives markets and how they operate.

…

14.2 **Entire Agreement:** The Agreement contains all of the terms, representations and warranties made between the parties with respect to its subject matter and supersedes all prior discussions and agreements relating thereto.

[109] The swap confirmations the Swans signed and returned on 27 January 2008 contained this text, in capitals, on the signature page, with a black border highlighting it:

EACH PARTY AGREES THAT IT HAS NOT RELIED ON ANY ADVICE (WHETHER ORAL OR WRITTEN) FROM THE OTHER PARTY (OTHER THAN AS SET OUT IN THIS CONFIRMATION) AND THAT (A) IT HAS THE CAPACITY TO EVALUATE THE TRANSACTION AND (B) IT UNDERSTANDS AND ACCEPTS THE RISKS AND OBLIGATIONS INVOLVED.

The contractual effect of the exclusion clauses

[110] Some of these exclusion clauses do not affect liability for pre-contractual misrepresentation in contract:

(a) The warranty at clause 4.1 cannot render true and accurate what was, in fact, inaccurate and misleading, which I examine in Issue 3.

(b) The entire agreement clause 14.2 does not affect the legal effect of a misrepresentation because, if s 6(1)(b) of the Contractual Remedies Act is met, Cygnet is entitled to damages "as if" it were a term of the contract irrespective of whether it was one or not.[81]

[111] The confirmation boxes, and most of the words of cl 10.1 have to be evaluated under s 4(1) of the Contractual Remedies Act. They cannot preclude a finding that Cygnet relied on the Bank's representations unless I consider that fair and reasonable having regard to all the circumstances of the case. Here, I would not consider it fair and reasonable for cl 10.1 to obviate Cygnet's reliance on representations or information but I would consider it fair and reasonable for the confirmation boxes to obviate reliance on advice. My reasons are those I give below in relation to the effect of the contractual terms and conditions on the duty of care in negligence.

[112] Most importantly, however, the Bank also submits the last sentence of clause 10.1 is effective in excluding the Bank's liability for Cygnet's loss: "[t]o the maximum extent permissible by law, the Bank will not be liable for the Customer's loss in any circumstances". The Bank says, correctly, that s 4(1) of the Contractual Remedies Act does not reach a clause that excludes liability. And, while it is not transparent, there is a logical linkage between the Swans' signature of the Authority and the terms and conditions, including clause 10.1. It is a term of the contract into which Cygnet entered. And it has the effect of excluding the Bank's liability in contract for the misrepresentations.

[81] Dawson and McLauchlan, above n 48, at 38.

[113] Construing the clause strictly does not yield a different result. The words of clause 10.1 are clear. By agreeing to it Cygnet assumed responsibility for losses from its reliance on misrepresentations by the Bank.

[114] I have considered whether it would be appropriate to adopt the literal approach to s 5 of the Act identified by Professors Dawson and McLauchlan. Clause 10.1 is similar to the hypothetical example they pose. But I do not consider a literal interpretation would be right. As Dawson and McLauchlan acknowledge, it is not what Parliament intended. Even the plain meaning of text must be cross checked by courts against Parliament's purpose in passing them.[82] The Court of Appeal has effectively endorsed a purposive interpretation.[83] And there are good reasons of certainty and predictability in the policy of the law of contract in enforcing terms where parties to a contract agree on the allocation of a risk. Perhaps this will be considered further on appeal but I do not consider the law of contract in relation to exclusion clauses should be altered to fill a gap attributable to legislative attenuation of a remedy in tort.

Was there a collateral contract?

[115] In some circumstances, courts can find there to be a collateral contract - a contract consideration for which is the making of another contract. The two contracts are independent of, but related to, each other. The leading text on contract law characterises collateral contracts in these terms: "the device may be used to enforce a promise given prior to the main contract and but for which this main contract would not have been made".[84] The attraction to a plaintiff of a collateral contract being found to exist is potential escape from clauses that exclude or limit liability in the main contract.

[116] Cygnet pursues this path by submitting there was a collateral contract whereby the Bank promised to provide investment advice during the life of the swaps and, but for that, the swaps would not have been entered into. The Bank

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82 *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36, [2007] 3 NZLR 767 at [22].

83 *The McKenzie Institute International v Accident Rehabilitation and Compensation Insurance Corporation,* above n 55.

84 *Burrows, Finn and Todd,* above n 47, at 84.

submits this claim must fail because, if representations were made and survive the exclusion clauses of the main contract, they must be treated as clauses of the main contract under s 6 of the Contractual Remedies Act.

[117] I consider it would be artificial to treat the pre-contractual representations as a wholly separate contract to that into which both parties entered. The terms of the two alleged contracts cannot stand together.[85] If Cygnet did not want its contractual rights to be governed by the exclusion clauses in the terms and conditions of the contract it entered into then it should not have entered into it having signed a document saying they did so governed by those terms and conditions.

Issue 2: Did the Bank owe a duty of care in negligence?

What duties of care are alleged?

[118] Cygnet submits the Bank was subject to the following duties of care:

(a) *Accurate explanation and honest replies:* to take reasonable care to ensure a proffered explanation is accurate or the reply to any inquiry is both honest and correct, in particular:

(i) any explanation as to the benefits of swaps over fixed rate loans would need to be correct and not misleading; and

(ii) any response to Mrs Swan's query as to the potential downsides of swaps would need to be accurate and not misleading;

(b) *Advice:* to take reasonable care in giving investment advice, in particular:

(i) to give sufficient advice so that Cygnet could make a fully informed decision as to whether the swaps were the most suitable product for its business (including providing

[85] *Burrows, Finn and Todd*, above n 47, at 84.

information on the negative aspects of swaps generally and vis a vis fixed rate loans); and

(ii) the exercise of reasonable skill and care in making recommendations.

[119] In response, the Bank says:

(a) The law does not impose a general duty on banks to advise their clients on the transaction into which they enter, citing New Zealand case law to that effect such as *Clarke v Westpac Banking Corporation* where Paterson J stated "a banker is generally under no duty to explain the nature and effects of documents which it is asking other persons, including guarantors, to sign".[86]

(b) The position is no different in a rural context or where the parties have an ongoing relationship, citing the Court of Appeal in *Forivermore Ltd v ANZ Bank of New Zealand Ltd* stating"[t]here is no authority to support [the] submission that the closeness of the relationship between a banker and its customer gives rise to a general duty of care".[87]

(c) A bank might, itself, specifically assume a duty of care and undertake to advise its customers on a transaction, but that cannot be so where the parties have expressly excluded such a duty by contract and it would have to involve going beyond the normal recommendations given between an institution's sales force and a purchaser of its products.

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[86] *Clarke v Westpac Banking Corporation* (1996) 7 TCLR 436 at [444], and see generally *Eadie v National Bank of New Zealand Ltd* HC Auckland CP1290/92, 12 December 2001 at [110], *Bank of New Zealand v Geddes* HC Auckland CIV-2009-404-8082, 28 May 2009, and *Forivermore Ltd v ANZ Bank of New Zealand Ltd* [2014] NZCA 129.

[87] *Forivermore Ltd v ANZ Bank of New Zealand Ltd,* above n 86.

Was Cygnet's loss reasonably foreseeable?

[120] Applying *The Grange* framework, the first question involved in establishing whether the Bank owed Cygnet a prima facie duty of care is whether Cygnet's loss was reasonably foreseeable. As Blanchard J said in *The Grange*, this is "at best a screening mechanism, to exclude claims which must obviously fail because no reasonable person in the shoes of the defendant would have foreseen the loss".[88] Reasonable foreseeability of loss is a necessary condition for a duty to exist.

[121] The losses Cygnet submits are at issue from the Bank's alleged breaches of its duties are the losses Cygnet suffered from entering into the swaps. At this generic level I agree that, to the extent Cygnet would not otherwise have entered the swaps, its losses from doing so were reasonably foreseeable by the Bank.

[122] There are disputes about elements of the claimed losses, their quantification, and the counterfactual. These disputes are best analysed below as a matter of causation and damages as the parties did in their submissions.

[123] However, Cygnet also claims its gross losses from entering the swaps. It does not want to account for the counterfactual even of having to pay interest on a floating rate term loan. I consider this fails the reasonable foreseeability screening test (as well as a causation analysis). Whatever the losses the Bank would reasonably have foreseen Cygnet would suffer from it breaching duties, they would be mitigated, at least, by the costs Cygnet must have incurred in entering the cheapest alternative form of financing of the loan – which turned out to be a floating rate loan.

Was there sufficient proximity in the Bank's relationship with Cygnet?

[124] The proximity analysis under *The Grange* framework asks whether there is sufficient proximity in the relationship between the Bank and Cygnet to establish, prima facie, the Bank owed Cygnet the above duties of care.[89]

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88 *The Grange*, above n 34, at [157].
89 At [163]-[165].

[125] There are a variety of considerations relevant to the proximity analysis here that were the subject of submission by the parties. These focussed on Gloster J's considerations in the English High Court in *JP Morgan Chase Bank v Springwell Navigation Corporation,*[90] endorsed by *Ellinger's Modern Banking Law*, and referred to in *Thornbridge Ltd v Barclays Bank Plc*.[91] These factors are:

(a) Cygnet's degree of commercial sophistication and financial acumen;

(b) the extent to which a bank has held itself out as offering advisory services or as a financial expert;

(c) the status and role within the bank of any individual with whom the customer deals and the capacity in which that person tenders any alleged advice;

(d) the possibility that the terms of the parties' contractual relationship may operate to negate the existence of any implied or concurrent duty of care.

(e) the regulatory background.

[126] I analyse the first three of these together as characteristics of the parties. These factors resonate with the consideration of "vulnerability" – or the relative bargaining power between the parties, often analysed in negligence cases.[92] Then I analyse the effect of the contractual relationship and then the regulatory background.

Expertise, promotion and vulnerability

[127] There was a clear imbalance in knowledge between Cygnet and the Bank regarding the nature of swaps. Mr and Mrs Swan are dairy farmers with a sideline in property development. They were familiar with loans and mortgages. They were

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90 *JP Morgan Chase Bank v Springwell Navigation Corporation* [2008] EWHC 1186 (Comm).

91 *Thornbridge Ltd v Barclays Bank Plc,* above n 32, at [70].

92 See, for example, *Rolls-Royce New Zealand Ltd v Carter Holt Harvey Ltd* [2005] 1 NZLR 324 (CA), citing *South Pacific Manufacturing Co,* above n 35, at 296 (per Cooke P) and 307 (per Richardson J).

not familiar with derivative instruments such as interest rate swaps. This is no doubt why the Bank considered they, like other such customers, required a special presentation about swaps. The Bank characterised Mr Swan as entrepreneurial or "a bit of wheeler and dealer", which his counsel accepted. I agree with the Bank that the Swans had a reasonable degree of commercial acumen. But they lacked an understanding of swaps and they lacked anything like the understanding of interest rate swaps possessed by the Bank.

[128] In the terms of the Bank's later identification, in its June 2009 training materials, of indicia of a customer's sophistication and understanding in relation to swaps, the Swans were not familiar with and had not used complex products such as derivatives and they were not familiar with the major influences on financial markets including the Reserve Bank, OCR, bill market and swap market. Consistent with "issue 1" of the issues identified by the Bank in June 2009 the Swans were "not sufficiently financially sophisticated to understand Interest Rate Swaps, and make their own decisions on them".

[129] Mr Esquilant was an expert in swaps. Mr Fleming was not – which is why he did not give the presentation to the Swans. But Mr Fleming was the Bank's designated "RM" for Cygnet and the Swans. They trusted him. This was the point of the position of RM, according to the Bank's own 2005 manual. Mr Hayden Dillon, expert witness for Cygnet, characterised an RM as a "trusted adviser" – the person the customer comes to first for any decisions, who they rely on to run through an idea.[93]

[130] Mr Fleming suggested and arranged the swap presentation by Mr Esquilant. Together, Mr Esquilant and Mr Fleming were a team which combined the Swans' trust in the Bank with the Bank's expertise in swaps. Mr Esquilant acknowledged this under cross-examination when he agreed that "it was helpful to the selling process if you had the RM as a trusted adviser there as well".[94] It is that combination which means it is difficult to escape the conclusion that the Swans, and therefore Cygnet, were relatively vulnerable vis a vis the Bank. There was a distinct

[93] Notes of Evidence 144/9-16.
[94] Notes of Evidence 208/32.

information asymmetry about swaps in the Bank's favour. And the Bank was promoting swaps as a product.

[131] I consider the expertise of the Bank, its initiation of active promotion of swaps, its trusted adviser status with Cygnet and the vulnerability of Cygnet supports there being sufficient proximity between the parties to found both of the duties contended for by Cygnet, subject to contractual considerations which I consider below.

[132] The first duty is to take reasonable care to ensure a proffered explanation is accurate and the reply to any inquiry is both honest and correct. The same duty was recognised by Paterson J in *Clarke v Westpac Banking Corporation*.[95] And essentially the same duty was recognised by the English High Court in *Crestsign v National Westminster Bank plc,*[96] relying on Mance J's statement in *Bankers Trust International plc v PT Dharmala Sakti Sejahtera*:[97]

> In short, a bank negotiating and contracting with another party owes in the first instance no duty to explain the nature or effect of the proposed arrangement to that other party. However, if the bank does give an explanation or tender advice, then it owes a duty to give that explanation or tender that advice fully, accurately and properly. How far that duty goes must once again depend on the precise nature of the circumstances and of the explanation or advice which is tendered.

[133] The Court in *Crestsign* found the bank's equivalent to Mr Esquilant was "under a duty to explain fully and accurately the nature and effect of the products in respect of which he chose to volunteer an explanation",[98] which extended to "correcting any obvious misunderstandings communicated by [the customer] and answering any reasonable questions he might ask about those products in respect of which [Mr Esquilant's equivalent] had chosen to volunteer information".[99] The same applies here.

[134] The second duty is to take reasonable care in giving investment advice, in particular to give sufficient advice so Cygnet could determine whether the swaps

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95 *Clarke v Westpac Banking Corporation,* above n 86, at 444.
96 *Crestsign v National Westminster Bank Plc* [2014] EWHC 3043 at [145].
97 *Bankers Trust International plc v PT Dharmala Sakti Sejahtera* [1996] CLC 518 at 533.
98 At [153].
99 At [155].

were suitable and to take reasonable care in making recommendations. I consider the circumstances of the relationship also support those duties being imposed on the Bank, subject to contractual considerations.

[135] The essence of Cygnet's decision on structuring the financing of its loans was to compare financial products. The Bank explained swaps as a product and compared them with alternative products, including their "negative" aspects. The explanation of swaps in the brochure was by way of comparison with a fixed rate term loan. This was the point of the presentation. It was the point of the Bank pursuing its whole strategy of promoting interest rate swaps as a product.

[136] In considering a similar duty to advise in relation to an interest rate swap the English High Court in *Crestsign v National Westminster Bank* found that, apart from the effect of contractual terms, the bank gave advice and a recommendation to the customer.[100] I consider what the Bank did here effectively constituted advice in the same sense. The Bank's own material indicated it would give advice to customers in relation to interest rate swaps:

(a) A general internal training presentation from 2005 by Mr Darren Young and Stuart Esquilant stated, under the heading "What do we do?"

> Advise and recommend to RMs/Clients interest rate risk strategies, including appropriate fixed rate exposure and optimal product mix to achieve financial objectives.

(b) The second slide of the flipchart presentation that Mr Esquilant said he would have used with the Swans, and on which I have found he likely based his presentation, states exactly the same thing under the heading "what we do".

(c) The brochure that was left with the Swans included a worked example at the end followed by 5 "Swaps Key points" of which number 4 was "[p]osition will be monitored by a treasury specialist who will provide ongoing advice".

[100] *Crestsign v National Westminster Bank Plc,* above n 96, at 106-111.

[137] Mr Esquilant agreed, under cross-examination, that he compared derivatives to fixed rate loans in his sales process including with the Swans.[101] He also reluctantly accepted that he could see how it could be taken by clients as implied that the Bank would manage their interest rate risk.[102]

[138] The Bank's best point in relation to expertise, promotion and vulnerability is that Cygnet had the capacity to obtain independent advice from a third party. So it did. Mr Esquilant advised them not to decide on the spot and to get independent advice. But the possibility of getting independent advice does not necessarily immunise a tortfeasor. Cygnet trusted the Bank, through Mr Fleming, and had access to the Bank's expertise, through Mr Esquilant. In the light of all the factors outlined above I do not consider Cygnet's capacity to seek a second opinion should mean the Bank should not have to take reasonable care to ensure its explanations were accurate, its replies honest and correct, its advice sufficient to assess suitability and in giving any recommendations.

The effect of the contract

[139] In both practice and theory, there is an uneasily ambiguous relationship between the laws of torts and contract where there are contractual relationships involving the parties. The contract, including the exclusion clauses, is relevant to assessing whether there is a duty of care in negligence.[103] Do the exclusion clauses negative the Bank's duty of care in negligence and negligent misstatement as part of the proximity analysis?

[140] The Bank:

(a) made a specific presentation promoting the swaps to Cygnet;

(b) compared swaps favourably with fixed rate loans;

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[101] Notes of Evidence p 251/10-29.
[102] Notes of Evidence p 194/14 – 196/9.
[103] While cast in terms of the proximity analysis of whether there was a duty, the same analysis answers the Bank's defences that Cygnet was contributorily negligent, and voluntarily assumed the risk, in going ahead with the swaps given the terms and conditions.

(c) offered to provide significant proactive service, help and advice in managing the risks and opportunities of swaps;

(d) indicated in its promotional material it would give advice in relation to interest rate swaps; and

(e) advised on the appropriate split of terms and interest rates of Cygnet's swaps.

[141] Cygnet did not have legal or financial advice in entering the swaps. They did not have anything like the expertise of the Bank regarding swaps and were relatively vulnerable. It is readily understandable that the Swans paid more attention to what they were told by Mr Fleming, and particularly by Mr Esquilant, than legalistic words on written documentation.

[142] But, as explained above, in its written documentation the Bank purported to modify or exclude the duties or liabilities for which Cygnet now contends. The terms of the contract were in a standard form rather than specifically negotiated or calibrated to this transaction. There is a disconnect between the Bank's oral interactions with the Swans and its written documentation to Cygnet.

[143] On balance, I consider the 19 December 2007 Terms and Conditions are not enough to negative the legal duties of the bank arising out of their relationship in tort. The Authority form the Swans actually signed and faxed back on 26 December 2007 was focussed on obtaining their financial details and authorised signatures. While the cover letter said the terms and conditions were important, the linkages between the signatures on the form and the 22 closely typed pages in legalese were not clear and transparent. They were mediated through a statement confirming the Customer agrees to be bound by the terms of the authority and through another buried sentence on the third page referring to "[a]ll foreign exchange and derivative transactions". I found above that these linkages are sufficient to give the exclusion clauses legal effect for the purposes of the law of contract which concerns the obligations agreed by the parties. But against all the context of the relationship traversed above I do not consider this means of invoking standard form terms and

conditions is sufficient to exclude the Bank's duties to take reasonable care imposed by the law of torts – particularly the duty to proffer honest explanations and provide accurate responses.

[144] However, I cannot accept that the duties imposed by the circumstances of the relationship are unaffected by the text in capitals, surrounded by a border, on the signed signature page of each of the two 27 January 2008. With regard to these confirmation boxes is difficult to know what more the Bank could have done to qualify its legal duties.

[145] The Swans' evidence is that they "weren't concerned" with what the written documentation said.[104] That may not be uncommon with these sorts of agreements. That is the customer's choice. But, if the Swans wanted to preserve their legal ability to assert the duties they do, they should not have signed documents containing such an explicit and well-highlighted term. Like the equivalent documentation in *Crestsign,* these words were unequivocal, they were clearly drawn to the attention of the customer and it must have been reasonable for the Swans to understand they were not empty words but were intended to have legal effect.[105]

[146] The effect of the confirmation boxes is to attenuate the duties arising out of the parties' relationship that are imposed by law. But the effect is not complete. The words in those boxes affect Cygnet's reliance on advice, its capacity to evaluate the transaction and its understanding and acceptance of the risks and obligations of the swaps. This does not obviate the Bank's duty to take reasonable care to ensure a proffered explanation is accurate or its reply to any inquiry is honest and correct. But it does mean Cygnet cannot rely on the second duty it alleges the Bank owed - to take reasonable care in providing investment advice.

Did the regulatory background enhance or detract from the duties?

[147] The regulatory framework of an industry is a contextual factor which helps to set the mutual expectations of the parties. As such it can affect the duties of care imposed by the common law on the basis of relationships between parties.

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104 Brief of Evidence of Craig Swan at [47].
105 *Crestsign*, above n 96, at [114].

[148] The English Court of Appeal considered such an argument in the interest rate swap case of *Green and Rowley v Royal Bank of Scotland.*[106] The Bank there was found not have undertaken to advise and did not advise on the swap transaction. In that context the Court of Appeal found the situation did not justify an independent imposition of a duty of care at common law to advise as to the nature of the risks inherent in a transaction regulated by the Conduct of Business Rules of the Financial Services Authority.

[149] Here, Cygnet submits that the regulatory environment reinforces its submissions about the Bank "crossing the line" from acting as seller of a product to an adviser. It points to the Securities Market Amendment Act 2006 which was passed on 24 October 2006 and came into effect from 29 February 2008. The Act defined "investment advice" and "advice" and provided for its regulation. In supplementary submissions it also points to the New Zealand Code of Banking Practice.

[150] I agree that this framework reinforces the proximity that I have found arises from the circumstances of the relationship between the parties anyway. But I do not consider it would sustain sufficient proximity on its own.

Are there policy considerations negating the Bank owing a duty to Cygnet?

[151] Victoria Stace's commentary earlier this year suggested it might be conceivable that the seller of a financial product who "fails to tell the customer about the full range of products available, or to assess suitability of the product or to take reasonable steps to ensure the customer understands the nature of the risks associated with a product, owes a duty of care to the customer".[107] Whether that is so depends on the context as analysed above. In addition, the implications of the potential for indeterminate liability deriving from a prime facie duty of care are to be considered along with other policy implications, as the Supreme Court noted in *The Grange*.[108]

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[106] *Green and Rowley v The Royal Bank of Scotland plc* [2013] EWCA Civ 1197, [2013] 2 CLC 634.

[107] Victoria Stace "Mis-selling Financial Products: When can the Customer Claim in Negligence?" [2016] JBL 517 at 528.

[108] *The Grange,* above n 34, at [159].

[152] Counsel for the parties here did not engage significantly on policy considerations, as counsel in New Zealand often don't. The Bank's primary submission was the general one that there was no basis to develop the law beyond the usual body of rules dealing with misstatements. Cygnet's submissions amounted to the claim that it was fair, just and reasonable to impose the duties alleged.

[153] Would the prima facie duties I have found to survive the inconsistent confirmation boxes impose too indeterminate a liability on banks? I do not have evidence, from either party, about the costs that imposition of such a duty would have on the banking industry or how that cost would show up in the industry or New Zealand cost of capital. However, I consider any such costs should be borne by the banks, rather than their customers, for the following reasons:

(a) First, the cost of satisfying the duties I have identified are highly likely to be less for the Bank than the information costs to consumers of having to insure or guard themselves against the risks that a bank's explanation is inaccurate or its replies dishonest or incorrect. Where such information asymmetries exist, the costs should be allocated to the party who faces the least cost of bearing it, which must be the banks. Allocating the cost to banks appropriately internalises the costs in their decision-making.

(b) Second, the duty to take reasonable care to ensure a proffered explanation is accurate or a reply to an inquiry is honest and correct is a narrowly constrained duty. If the marginal cost of a financial product meeting those minimal standards is financially prohibitive that would suggest the product should not be promoted.

(c) Finally, there is an intuitive sense of justice about a bank with expertise in a product being required to be honest, accurate, correct and not misleading in explaining its product to dairy farmers.

[154] So on the basis of the circumstances of this case and the relationship between the parties as a whole, I consider it is fair, just and reasonable for the law to impose a

duty on the Bank to take reasonable care to ensure explanations it proffers are accurate and its reply to inquiries are honest and correct.

Issue 3: Did the Bank make misrepresentations?

[155] If the Bank made misrepresentations then it may have breached its duty of care in negligence and in negligent misstatement, made a pre-contractual misrepresentation and/or breached s 9 of the Fair Trading Act. I examine the four alleged misrepresentations in turn.

1 Swaps were not a fixed rate loan with upside

[156] I have found the Bank represented to Cygnet that the swaps were like a fixed rate loan with upside. That general characterisation may have seemed fair to Mr Esquilant at the time, before the GFC hit, because some features of swaps were latent in practice until then. But it was not accurate and it was misleading. It did not identify there are some downsides of swaps compared with a fixed rate loan. In response to Mrs Swan's specific query at the presentation Mr Esquilant stated there were no real downsides.[109]

[157] There were three downsides that the Bank failed to explain.

(a) *Credit Margin:* First, unlike fixed rate loans, the Bank retained the ability to increase the margin on a swap, and therefore the overall interest rate faced by the borrower. I have found the Bank did not explain that to Cygnet. The ability to increase the margin on a swap is a significant difference to a fixed rate loan. As a matter of policy, even during the GFC, the Bank increased margins on swaps much less than it increased margins on floating rate loans. But it couldn't increase them at all on fixed rate loans which was the subject of the comparison it made. The Bank did not explain this to the Swans. In failing to ensure its explanations as to the benefits of swaps over fixed rate loans were correct and not misleading, the Bank breached its duty of care.

[109] Brief of Evidence of Lisa Swan at [20].

(b) *Credit Limit:* Second the Bank breached its duty in the same way by failing to explain the additional credit limit (the MRR) imposed in relation to swap customers. I have found it failed to do. The MRR affected the Bank's assessment of the security of lending to Cygnet. There is no MRR in relation to a fixed rate loan. So this is another disadvantage which was not explained. That failure also means the explanation of the benefits of the swaps were incorrect and misleading.

(c) *Breek fees:* Third, the Bank breached its duty by failing to explain the break fees for a swap were calculated on a different basis than the break fees for fixed rate loans. The Bank accepts it failed to do this.

[158] In misrepresenting that swaps were like fixed rate loans with upside the Bank breached its duty of care in negligence and it made a misrepresentation for the purposes of negligent misstatement, pre-contractual misrepresentation and the Fair Trading Act.

2 The swaps were not suitable

[159] The Bank represented interest rate swaps were suitable for Cygnet. That was wrong. Mr Esquilant's belief that $5 million qualified a customer as suitable is startlingly wrong. Even putting aside the relative lack of investor sophistication emphasised by the Bank's later training materials, interest rate swaps were not a particularly suitable product for Cygnet. Putting all the loan funding into swaps carrying a potentially high break cost was an inflexible approach to structuring its finance. That was not suitable when the Bank knew Cygnet may have cash inflows which it might wish to repay debt. Even if the sale of the Bell Block properties did not require breaking the swaps to repay debt, the Bank knew about the terms of the Swan Family Trust guarantee which could require sale of the Cornwall Road property, which is what occurred.

[160] The Bank did not discuss with the Swans whether they were likely to want to repay any of the loan that would be the subject of the swaps, for example, on sale of Bell Block properties. In the 8 January 2009 conversation with Mr Swan, Mr

Whittaker's attitude to the desirability of breaking the swap entirely changed when he discovered the Swans expected cash flows from their property development.

[161] If I had found the Bank's duty to give investment advice survived the swap confirmation boxes, I would have found the Bank had breached that duty by failing to give sufficient advice to Cygnet as to whether the swaps were the most suitable product for them. I hold that the Bank made misrepresentations to that effect for the purposes of negligent misstatement, pre-contractual misrepresentation and the Fair Trading Act.

3 Proactive advice was not provided

[162] The representations that the Bank would provide significant proactive service, help and advice relating to managing Cygnet's risks and opportunities of the swaps were also inaccurate and misleading. The Bank's evidence is that it would alert customers to opportunities for restructuring swaps when they were in the money. But the Bank does not say it provided advice on managing Cygnet's risk and opportunities with the swaps. Indeed the Bank's Markets team did not contact Cygnet between December 2007 and November 2008. Contact in that last month was at the behest of the Credit team, regarding what break fees would be required by paying down the core debt.[110]

[163] Cygnet also submits that, if it was providing significant proactive service, or even something less than that, the Bank should have provided advice to Cygnet on breaking the swaps in July 2008 when it was clear they were becoming significantly disadvantageous. I am not persuaded that is so as at July 2008. Cygnet's expert, Ms Shelley Cooper says a financial adviser would have recommended exiting the swap in June 2008, due to a Reserve Bank statement of 5 June 2008 which indicated market interest rates would fall over the course of the year.[111] But it was only around the end of June 2008 that the Bank's own updates stopped advising against floating rates and even then it did not recommend them. It is not reasonable to expect the Bank's advice to its swap customers to run ahead of its own economic forecasts.

[110] Brief of Evidence of Craig Swan at [70]-[75] and CB 637.
[111] Brief of Evidence of Shelley Cooper at [65].

[164] Finally, in relation to pre-contractual misrepresentation, there is a question about whether the representations about providing proactive advice about swaps were of a present fact or a future intention which does not found liability. I consider the statement that the Bank intended to provide such advice was untrue and implied the Bank was ready, able and willing to do so. On both grounds, it was an actionable misrepresentation.

4 The forward start was not unreasonable

[165] I have found the Bank represented the swaps should be entered into before settlement of the Finnerty Road property to take advantage of the interest rates available. In the telephone conversation between Mrs Swan and Mr Esquilant of 25 January 2008, Mr Esquilant did make recommendations on behalf of the Bank. He agreed it was "probably a good idea" to lock in an interest rate and said "let's do it now rather than wait". He actively suggested splitting the swaps in half with three and five year terms.

[166] It is true that the Bank's June 2009 training material identified that swaps had been used in inappropriate situations such as extended forward starts. But I don't consider this was a misrepresentation or in breach of a duty to take reasonable care in advising. At that point, it was not unreasonable to consider that interest rates may rise and to lock in a rate in January 2008. Rising interest rates can be expected in a credit crunch. It was only the later intervention by central banks in increasing liquidity on a global scale that led to such a large and unexpected drop in interest rates. And the parties agree Cygnet was sensitive to interest rate rises due to the fragility of its business case for the purchase, which relied on efficiency gains even for viability. In light of the market conditions at the time, it was not unreasonable.

[167] The forward start with swaps was unreasonable in light of the Swan's property development business and expectation of cash inflows. But that is the problem of suitability examined above, not a problem with the forward start in itself.

[168] So I do not consider the advice the Bank gave to make a forward start was made without reasonable care or was a misrepresentation.

5 Cygnet did have to break the swap

[169] Cygnet also submits the Bank breached its duties to offer accurate explanations and honest replies when it advised Cygnet in November 2008 that if it wished to repay $200,000 of debt under the floating rate loan then it had to break, or break and extend, a swap. Cygnet says that was wrong because Cygnet could have elected to be over-hedged so that the amount of the swaps exceeded the loans. Given the circumstances at the time, during the GFC, the Bank required Cygnet to repay its debt. Cygnet did not have a choice about repaying the loan. I agree that the Bank could have allowed Cygnet to be over-hedged, but it did not. It can hardly have misrepresented a situation it was contractually entitled to decide was not available.

Misrepresentations

[170] On the basis of the above misrepresentations by the Bank in relation to the downsides of the swaps, their suitability and the availability of proactive advice, I hold that the Bank:

(a) breached its duties to take reasonable care that explanations it proffered were accurate and its replies to inquiries correct;

(b) would have breached it duty to advise if that had not been negatived by the confirmation boxes;

(c) made misrepresentations for the purposes of negligent misstatement, and s 9 of the Fair Trading Act and (if liability were not excluded) pre-contractual misrepresentation.

Issue 4: Did Cygnet rely on the misrepresentations?

[171] As noted above, a pre-contractual misrepresentation must reasonably and materially induce, and have been intended to induce, entry into the contract in order to be actionable. Reasonable reliance is likely to be required for negligent misstatement. These are similar concepts.

[172] Cygnet was left with little reason not to enter the swaps due to the misrepresentations that the swaps were like a fixed rate loan with upside and flexibility and were suitable for Cygnet. The Bank had approved the loans and only their structuring remained to be decided. The Bank asked to make a presentation on swaps as an option. It compared swaps with fixed rate loans, with which the Swans were familiar. The Bank did not identify the downsides to swaps that are now at issue. The Swans say that if they had been advised margins could increase, unlike a fixed rate loan, and that a break fee would be incurred by repaying debt, they would "definitely" not have entered the swaps. In terms of the different calculation methods for break fees, and the fact an MRR would be imposed, Mr Swan says he is not sure what he would have done because he would have needed to first understand their downsides.[112] I consider it was reasonable for Cygnet to rely on, and it did rely on, these misrepresentations. They were material, intended to induce and reasonably induced Cygnet's entry into the contract.

[173] The same is true of the misrepresentation that the Bank would provide proactive advice regarding the swaps. The Swans' evidence is that the promise of assistance and advice was the standout reason for them getting into the swaps, and it was important to them as the swaps were complicated.[113] The promise of assistance with a product that was "hard to understand" made Mrs Swan, at least, feel "safe" signing up.[114] I consider it was reasonable, and Cygnet did, rely on this material misrepresentation. It was one of the reasons which reasonably induced, and was intended to induce, their entry into the contract.

[174] Clause 10.1 and the confirmation boxes break reliance to the same extent they negate a duty in tort and liability in contract, as analysed above. Otherwise, I am satisfied that the three misrepresentations here, understood as a reasonable person would understand them, were material, were intended to induce entry into the contract, and were reasonably relied on by Cygnet inducing their entry into the contract.

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[112] Brief of Evidence of Craig Swan at [46].
[113] Brief of Evidence of Lisa Swan at [18].
[114] Brief of Evidence of Lisa Swan at [18].

Issue 5: Fair Trading Act limitation

[175] Section 43A of the Fair Trading Act empowers a person to "apply to a court ... for an order under s 43 at any time within 3 years after the date on which the loss or damage, or the likelihood of loss or damage, was discovered or ought reasonably to have been discovered."

[176] In *Commerce Commission v Carter Holt Harvey* the Supreme Court has clarified that:[115]

(a) "time starts running when the applicant discovers or ought to have discovered that loss or damage has already occurred, or is likely to occur in the future".

(b) discovering loss means being aware of it;

(c) being likely to occur means loss is more probable than not; and

(d) the loss that must be discovered is more than minimal loss.

[177] Cygnet's Fair Trading Act claim was made as an amendment to the Statement of Claim on 26 August 2015. Cygnet says, and the Bank does not dispute, there was a standstill agreement between the parties as to limitation for 29 days. So the limitation period would have had to have extended from 28 July 2012 for that claim to be in time.

[178] The Bank submits Cygnet must have known the representations were incorrect much earlier than that. The break fees became apparent after the Cornwall Road sale in July 2008. The Bank told Mr Swan on 8 January 2009 that it would be better off breaking sooner rather than later if it did not need the swap. The margin increased on 20 April 2009.

[115] *Commerce Commission v Carter Holt Harvey Ltd* [2009] NZSC 120, [2010] 1 NZLR 379 at [27], [29], [30] and [34].

[179] Cygnet submits discovery of loss is connected with a claimant's awareness their loss has been caused by contravention of the Fair Trading Act. Surprisingly, if it had legal advice, Cygnet says it did not connect the Bank's conduct with contravention of the Fair Trading Act until it read reports in the press. It says it needed to understand the "strict legal position" regarding the margin could be overridden by the Fair Trading Act or common law. It says the MRR issue arose out of discovery and expert advice. It says it "raised issues" with the Bank on 19 October 2012 so it had until 17 November 2015 to file the Fair Trading Act claim.

[180] Raising issues is not the same as applying to a court for an order, which is what s 43A requires. And time starts to run from the claimant's discovery of loss, not from "discovery" of the legal basis for proceedings.[116] The purpose of the three year time period is to allow a claimant time to formulate a legal claim. That was not done in time here. It was quite clear to Cygnet that it suffered losses from each of the misrepresentations well before 2012. It was clear to Cygnet from July 2008 a swap was not like a fixed rate loan and was not suitable for it. It was clear by January 2009 the Bank was not providing proactive advice.

[181] Accordingly, I consider the Fair Trading Act claim is time-barred for all of the representations.

Issue 6: Causation, loss and damages

Causation and loss

[182] If they were available, all of the causes of action pleaded require loss to have been caused by the breach of duty, misstatement, misrepresentation, or breach of the Fair Trading Act. Establishing what loss was caused by Cygnet entering the swaps requires me to establish what would have happened if they had not done so.

[183] Cygnet says it would have had a floating rate loan had the Bank not breached its duties or had it not made its misrepresentations. The Bank says the vast majority of the opportunity cost of the swaps represents the lost opportunity to benefit from the historic fall in interest rates during the GFC. It says that is the potential benefit

[116] *Houghton v Saunders* HC, Christchurch, CIV 2008-409-348, 8 June 2011 at [111].

that Cygnet agreed to forego in return for the certainty of a fixed rate. It also submits the sale of the Cornwall Road property in July 2008 would not have led to a reappraisal of the entire hedging strategy since the Bell Block properties were not selling then, there was only a surplus of $200,000 available in November 2008 and, as it was, the rest of the debt was not discharged until Cygnet refinanced in July 2013.

[184] I consider there are difficulties with both parties' positions. The Swans' evidence is that all their other loans were at floating rates but that was not the case with the Mokau properties. They say, now, this would have been a floating loan if they had not been persuaded to enter the swaps. A fixed rate loan would have been unsuitable. As with their suitability argument regarding the swaps they point to their strategy of selling Bell Block properties and their expectation of capital inflows as indicating they would not have had a totally fixed rate loans. But, as the bank points out, it is logically difficult for Cygnet to say it was relying on the swaps being like a fixed rate loan to establish liability and then to say that, if it hadn't entered the swaps, it would have had a floating rate loan. This is especially so where the business case for the purchase of Finnerty Road was so fragile that a positive cash flow depended on the Swans making efficiency improvements to its operation. Cygnet's financial position was, as the Bank emphasised, particularly sensitive to increases in costs.

[185] Formulating the counterfactual is always somewhat artificial. In these circumstances I do not consider Cygnet would have been likely to enter a completely floating rate loan if it had not entered the swaps. I consider it is more likely to have spread its risk, as it did in terms of interest rate and term between the two swaps it entered into. Accordingly I would consider that Cygnet's losses from entering the swaps should be assessed against the counterfactual that it would have had one loan at a fixed rate and one at a floating rate. For the purposes of quantification I would assume it to have entered a floating rate loan for $2 million for three years and a fixed rate loan for $1.94 million at the then going rates of interest.

[186] I consider the Bank's breach of the duty to take reasonable care that explanations it proffers are accurate and that its replies to inquiries are correct caused

Cygnet to enter into the swaps and lose the equivalent of the difference between its payments under the swaps and what its payments would have been under a fixed and a floating rate loan.

[187] And I consider that the misrepresentations made by the Bank about the downsides of the swaps, their suitability and the availability of proactive advice had the same effect for the purposes of negligent misstatement and, if it were not time-barred, the Fair Trading Act. If liability had not been negatived by the exclusion clauses, they would have had the same effect as pre-contractual misrepresentations.

Damages

[188] The difficulty with the outcome of this case lies in the lack of availability of damages as a remedy. As noted above, damages in tort restore the plaintiff to the position of the tort, the misrepresentation, not having occurred. Damages in contract restore the plaintiff to the position where the contract is performed on the basis the misrepresentation is true.[117] And s 6(1)(b) of the Contractual Remedies Act provides that only contractual, not tortious, damages are available where a party to a contract has been induced to enter into it by a misrepresentation.

[189] This leads to an unfortunate result:

(a) Liability for pre-contractual misrepresentation in contract is excluded by clause 10.1.

(b) The Fair Trading Act claim is out of time.

(c) Although I have found the Bank liable in negligence and negligent misstatement, s 6(1)(b) of the Contractual Remedies Act precludes me from awarding Cygnet damages.

[190] This situation is unfortunate, given the equitable maxim "where there is a right there is a remedy". But I consider that is the effect of the law. In precluding damages in negligence, for a misrepresentation inducing a party to enter a contract,

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[117] *Burrows, Finn & Todd* above n 47, [11.2.6] at 370.

Parliament created a gap in the law in 1979. The gap does not appear to have been highlighted directly by a case until now. Parliament intended the law of the contract, not torts, to govern the availability of damages. It is not clear to me Parliament appreciated the possibility that there could be no liability in contract and liability in tort but no damages in tort. However, any change to the law must be made by Parliament. I will also forward a copy of this judgment to the Law Commission for consideration.

[191] I should note, in case I am proved wrong on appeal, what my approach to damages in tort would have been had had they been available. I would have invited further submissions on these points. But I would have started from the assumptions that the costs of the counterfactual fixed rate loan would have been equivalent to those for swap 2 and would have given rise to no loss. And the total costs of the counterfactual floating rate loan, including the margin Cygnet would have paid, would have been less favourable to Cygnet than was Swap 1 until it was broken in January 2009. So the damages I would have awarded would have been the net break fee of $218,388 plus the interest on the loan advanced to meet that break fee plus the effect of the principal reduction of $200,000 minus the difference between the cost of Swap 1 until it was broken and the counterfactual floating rate loan.[118]

Result

[192] I have concluded that:

(a) The Fair Trading Act claim is out of time.

(b) There was no collateral contract.

(c) Liability for pre-contractual misrepresentation in contract is excluded by clause 10.1 of the contract.

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[118] Because Swap 1 was broken in January 2009, Cygnet's arguments fall away for damages recognising the effect of the credit limit in raising the margin from October 2009 And the effect of a principal reduction of $200,000 in November 2008.

(d) Although the Bank is liable in negligence and negligent misstatement, s 6(1)(b) of the Contractual Remedies Act 1979 precludes me from awarding Cygnet damages.

[193] All the law permits me to do is to make a declaration which Cygnet also sought. I declare that, in promoting and entering into interest rate swaps with Cygnet the National Bank, now ANZ Bank New Zealand Ltd, breached the duties arising from its relationship to take reasonable care that explanations it proffered were accurate and that its replies to inquiries were correct.

[194] Because it has succeeded on liability and in obtaining declaration, if not damages, I am inclined to award costs to Cygnet. I would entertain submissions to award costs on an indemnity basis. If the parties cannot agree on costs I give Cygnet leave to file submissions of no more than 10 pages within 20 working days of this judgment and the Bank leave to file submissions in reply 10 working days after that.

....

Palmer J