Bank references: liability to an undisclosed principal

While acknowledging that the principle established in *Hedley Byrne v Heller* is capable of incremental development, the Supreme Court refused to extend it to a case where a bank provided a reference to an agent and the bank had no knowledge of that agent's undisclosed principal (*[1964] AC 465*; *Banca Nazionale del Lavoro SpA v Playboy Club London Limited and others [2018] UKSC 43*). As a result, the bank was not liable to the undisclosed principal for negligent misstatement in tort.

Under the contractual doctrine of undisclosed principal, a party to a contract may be sued on that contract by the undisclosed principal of the other party. Here, the undisclosed principal sought to extend this doctrine to tort, asserting that, save for a lack of consideration, the relationship between the bank and the undisclosed principal was akin to the relationship in contract. The Supreme Court acknowledged that this argument was "ingenious" but, ultimately, it failed.

The decision will be welcomed by banks but should also serve as a cautionary tale as to the importance of including a disclaimer on bank references. As a matter of English law, an express disclaimer of responsibility will typically succeed in defeating a claim by a third party that relies on that reference.

Applying *Hedley Byrne*

In *Steel and another v NRAM Limited (formerly NRAM plc)*, the Supreme Court held that Ms Steel, a solicitor acting for a borrower, was not liable to the lender bank, NRAM, for negligent misrepresentation (*[2018] UKSC 13*). Ms Steel was acting for the borrower in relation to the sale of one of three units of a property over which NRAM had security. Ms Steel had incorrectly indicated that the borrower would repay the whole loan and attached deeds of discharge in respect of all the units, which NRAM signed. However, NRAM had expected its security to remain in place over two of the units to secure the balance of the loan. The borrower went into liquidation and NRAM sought to recover its loss from Ms Steel.

The key question here was, following *Hedley Byrne v Heller* and *Caparo Industries plc v Dickman*, whether it was reasonable for NRAM to have relied on Ms Steel's representation and for Ms Steel to have reasonably foreseen that it would do so (*[1964] AC 465; [1990] 2 AC 605*). The court concluded that it was not reasonable for NRAM to have relied on the representation without checking its accuracy, as it was a fact wholly within NRAM's knowledge, and it was reasonable for Ms Steel not to have foreseen that it would do so.

The bank reference

In October 2010, a Mr Hassan Barakat visited the Playboy Club (the club) to gamble. In order to do this, he applied for a cheque-cashing facility from the club of up to £800,000. The rules of the club required a credit reference from Mr Barakat's bankers for twice the amount of the facility. However, it was not the club's practice to ask for the reference from a patron's bank directly; instead it used an associated company, Burlington Street Services Limited (Burlington), in order to protect the confidentiality of its patrons.

Mr Barakat asked the club to request the reference from his bank, Banca Nazionale del Lavoro (BNL), in Italy. Burlington's request for the reference made no mention of the club or the purpose for which the reference was sought. BNL confirmed to Burlington that Mr Barakat had an account with it and that he was trustworthy up to £1.6 million in any one week. It stated that the information was given in strict confidence but the reference contained no other disclaimer of responsibility by BNL.

In reliance on the reference, the club granted Mr Barakat the cheque-cashing facility, and shortly afterwards increased the limit of the facility to £1.25 million. Mr Barakat drew two cheques on BNL for a total of £1.25 million for gaming chips and the club paid out winnings of £427,400 to him. After gambling for four days, Mr Barakat left the club and did not return. Both cheques were returned unpaid.

BNL accepted that it had no basis for the terms of its reference. It later confirmed that Mr Barakat had only opened an account with it two days after the reference was given, and had maintained a nil balance until its closure.

The club and Burlington, together with an associated company, successfully sued BNL in the High Court for negligent misstatement in giving the reference, finding that BNL owed the club a duty of care in relation to the reference (*[2014] EWHC 2613*). The Court of Appeal disagreed, holding that the duty of care was owed only to Burlington, as that was who the reference was addressed to, and not to the club, as Burlington's undisclosed principal (*[2016] EWCA Civ 457*). The Supreme Court agreed with the Court of Appeal.

Assumption of responsibility

In *Hedley Byrne*, the House of Lords held that a purely economic loss can be recovered in negligence where the existence of a special relationship between the claimant and the defendant makes this appropriate. This special relationship can be ad hoc, for example where someone is seeking a reference. In this situation, it is necessary to examine the facts to see if there is an express or implied undertaking of responsibility by the party that provides the reference.

While the Supreme Court acknowledged that the principles governing when liability arises for negligent misstatement in tort are capable of incremental development over time, it held that the law had not moved on from *Hedley Byrne* in respect of one fundamental characteristic; that is, there must be an assumption of responsibility by a defendant towards the claimant.

The court emphasised that the defendant must assume a responsibility to an identifiable, although not necessarily identified, person or group of persons, and not to the world at large or to a wholly indeterminate group. This echoed the House of Lords in *Caparo Industries plc v Dickman* where it said that for this assumption of responsibility to arise, the defendant giving the advice or information must be fully aware of the nature of the transaction that the claimant had in

contemplation and, subject to the effect of any disclaimer, the defendant must be aware that the claimant would rely on the advice or information (*[1990] 2 AC 605*).

Here, the club accepted that there was no evidence that BNL knew that its reference would be given to or relied on by anyone other than Burlington. This was the crucial difference to the facts of *Hedley Byrne*, where the party that would be relying on the reference might have been unknown but would have been readily identifiable. In contrast, BNL did not assume any responsibility to the club and had no reason to suppose that Burlington was acting for anyone else.

The club submitted that the relationship between BNL and the club was akin to a contract and, indeed, lacked only consideration. In contract, the club would have been entitled to declare itself as the undisclosed principal of Burlington and thereby assume the benefit of, and the right to sue under, that contract. The court found that this was an ingenious but fallacious argument, and dismissed it.

Practical implications

Both *BNL* and the Supreme Court's recent decision in *Steel and another v NRAM Limited (formerly NRAM plc)* demonstrate that, while *Hedley Byrne* may be incrementally developed by the courts, it remains good law and is ultimately founded on the core principle of assumption of responsibility (*[2018] UKSC 13; see box "Applying Hedley Byrne"*).

BNL contains some important best practice points for those providing and requesting references.

While BNL is based in Italy, English law and practice governed the claim. BNL escaped liability as it was unaware of the undisclosed principal or that any such principal would rely on any reference to its detriment. However, a more definitive means of avoiding liability would have been a disclaimer. It therefore remains best practice for banks to limit the extent of any reference to an identifiable group of people who will rely on it and to add a disclaimer of responsibility in respect of any people outside of that identified or identifiable group.

Conversely, in order to extend the scope of individuals who may seek to rely on a reference, the person seeking it should try to ensure that the reference is drafted sufficiently widely so as to cover all such individuals, including parent or associated companies. They do not need to be identified by name, but they do need to be identifiable or part of an identifiable group or class.

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