The Financial Ombudsman Service and the doctrine of merger

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An important principle concerning the legal status and practical effect of determinations made by the Financial Ombudsman Service (FOS) is listed for hearing next month by the Court of Appeal. The appeal is from the decision of Cranston J in *Clark v. In Focus Asset Management & Tax Solutions Ltd*[1], a decision that had caused something of a stir when handed down in December 2012. In apparent conflict with the decision by His Honour Judge Pelling QC in *Andrews v. SBJ Consultants*[2], if correct, it permits complainants to bring legal proceedings notwithstanding their acceptance of a favourable determination made by FOS.

Facts

Mr and Mrs Clark successfully appealed against the striking -out of their claim for damages against the defendant, a company which had provided allegedly negligent tax and investment advice resulting in losses stated to be in excess of £500,000. They had first made a complaint to FOS pursuant to Part XVI of the Financial Services and Markets Act 2000 (FSMA).

Under this statutory scheme FOS has power to resolve consumer disputes adopting mediation and other informal dispute resolution procedures in order to resolve certain disputes submitted by eligible complaints, broadly speaking being consumers and small businesses, as speedily and with the minimum of formality as is necessary.[3] The scheme is bolstered by a statutory power to require disclosure of documents and other evidence, enforcement of which may be achieved through contempt of court proceedings before the High Court[4]. The jurisdiction of FOS extends beyond application of English law to good market practice and to what FOS considers to be fair and reasonable in all the circumstances. The process is susceptible to judicial review[5], and must have regard to the European Convention on Human Rights when deciding whether to hold a hearing or to deal with the complaint on the papers. FOS may give directions as to the issues and as to evidence, may include evidence which is not admissible before an English court and has power to accept evidence in confidence. [6]Awards in favour of the complainant are of 'fair compensation'; but there is also power to make awards for recompense to complainants other than by money sums, and whether or not that is within a court to grant.[7] Awards, currently up to a maximum of £150,000, are final and binding on the parties but this is so only on acceptance by the complainant; such awards are then enforceable as if made by a county court. The scheme is thus asymmetric in that the complainant is neither obliged to submit a complaint to the scheme nor to accept a decision made; his rights of action are thereby potentially preserved. Crucially, FOS may only make recommendations as to payment of sums in excess of the financial ceiling. [8]

In this case FOS found in favour of Mr and Mrs Clark and made a final award up to the financial limit of £100,000 then being in force[9] but with a recommendation for payment of sums above that sum. The respondent paid the sum awarded but no more. Consequently, Mr and Mrs Clark commenced legal proceedings against the firm in order to recover the full extent of the alleged losses, giving credit for the sum paid. That claim was struck out on the basis that the proceedings constituted an abuse of the process, specifically in that the doctrine of merger applied[10] : Mr

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[1] [2012] EWHC 3669 (QB); [2013] PNLR 14.
[2] [2010] EWHC 2875 (Ch); [2011] Bus LR 1608.
[3] Sections 225-226 FSMA; further detail is contained with DISP section of the FCA Handbook.
[4] Sections 231-232 FSMA.
[5] R (on the application of Heather Moor & Edgecomb Ltd v. Financial Ombudsman Services [2008] EWCA Civ 642; [2008] BLR 1486.
[6] DISP section of the FCA Handbook.
[7] Section 229 FSMA.
[8] Section 228 FSMA.
[9] Increased to £150,000 in January 2012.
[10] Following Andrews v. SBJ Benefit Consultants Ltd [2010] EWHC 2875 (Ch); [2011] Bus LR 1608 to the effect that the doctrine of merger applies to decisions of the Ombudsman.

and Mrs Clark had obtained an award and so there was no further right of action on the same subject matter. Furthermore, by accepting the award, notwithstanding an express reservation as to a purported right to make further claim, any such further rights were extinguished. Mr and Mrs Clark appealed the order of strike -out.[11]

The issues before Cranston J were whether (i) the doctrine of merger[12] applies to decisions of the FOS; (ii) the reservation of rights on Mr and Mrs Clark's acceptance of the award put an end to any further right of action; and (iii) they had any remedy by way of unjust enrichment following a mistake in law as to the effect of the FOS award.

The Decision

(1) FOS deals with complaints rather than with causes of action and so the doctrine of merger does not easily apply in this context.[13] Whether that is the correct result is to be determined by a detailed analysis of the functions of the scheme. A number of factors were pertinent to suggest that the FOS is not a form of tribunal for the purposes of the doctrine of merger: the process might include mediation; non- binding recommendations might be made; binding awards only become binding once accepted by the complainant; and, significantly, the process deals with complaints rather than causes of action. Furthermore, the statutory scheme contains no express provision to bar further proceedings notwithstanding the reference to accepted determinations being final and binding. In most cases there will be no point in taking legal action once a favourable award had been made but this is not so for complaints of loss above the statutory limit. Overall, the scheme is neutral on the issue of whether favourable awards once accepted put an end to further proceedings; the reference to finality may only refer to the FOS process and to no more. The decision in *Andrews v. SBJ Benefit Consultants Ltd*[14] which held to the contrary was in error. (2) *Obiter*: the claimants had made a mistake of law when purporting to accept the award subject to a reservation of rights as to further action. Contractual notions of offer and acceptance have no part to play in this statutory scheme but the acceptance would not of itself prevent the doctrine of merger from applying.[15] The award had been accepted despite the rider to the acceptance. There was no error or fault on the part of the FOS in the advice given nor any fault on the part of the defendants; there was thus no relief by reference to principles of restitution.

Comment

As Cranston J noted FOS has been highly successful: consumer complaints are routinely dealt with in a speedy and relatively informal process, all without recourse to the courts. The process is perceived to be 'consumer friendly' as is the jurisdiction[16]. The gains are not wholly one sided: for insurers and other authorised firms operating in the UK consumer insurance market disputes with their customers may be resolved relatively informally and at reduced cost as compared with the civil court process. Moreover, an adverse order for payment of legal costs is not commonly made and adverse publicity is largely avoided. It might be argued that this form of specialist tribunal actively facilitates improvements in market practice to the benefit of the UK insurance industry in a general sense.[17]

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[11] Fraser v. HMLAD [2006] EWCA Civ 738.

[12] This doctrine holds that a person in whose favour an English tribunal of competent jurisdiction has pronounced a final judgment is precluded from afterwards recovering before an English tribunal a second judgment from the same civil relief in the same cause of action: Republic of India v. The India Steamship The Indian Grace [1993] AC 410 at 417, per Lord Goff referring to Spencer Bower and Turner, Res Judicata, 2nd edn 1969 at p355. The cause of action is said to cease to exist (*transit in rem judicatam)*, referring to Diplock LJ in Thoday v. Thoday [1964] 1 All ER 341 at 352.

[13] Referring to obiter remarks by Rix LJ in R (Heather Moor & Edgecomb Ltd) v. Financial Ombudsman Service Ltd [2008] EWCA Civ 642; [2008] BLR 1486 at paras 79-80.

[14] [2010] EWHC 2875 (Ch); [2011] Bus LR 1608.

[15] Wright v. London General Omnibus Authority (1877) 2 QBD 271; Fraser v. HMLAD [2006] EWCA Civ 738; [2007] 1 All ER 383.

[16] Largely as a result of the recent project of the Law Commission there have been some moves towards narrowing the gap between strict English law and the practice of the FOS, most notably by the Consumer Insurance (Disclosure and Representations) Act 2012.

[17] FOS publish annual reports and case notes which inform and educate authorised firms.

At first blush the outcome of this decision appears to be in favour of consumers: existing rights of action are preserved notwithstanding a favourable FOS decision and recovery of some part of the compensation sought. The prospect of legal proceedings with the intention of enforcement of recommendations of FOS may also serve to give 'teeth' to these recommendations which otherwise have none other than what moral or other pressure FOS is able to bring to bear. Against this is the argument that this decision, assuming legally sound, undermines the objective of an efficient and economic despatch of financial disputes; the result could be to encourage matters of complaint being ventilated twice, once via the FOS and a second time through court proceedings, and that this potentially increases the burdens on courts at a time when the system is struggling to manage fair allocations of time and other resources as between litigants.[18] There is also some increased prospect of conflicting decisions reached as between FOS and the civil court which might weaken the standing of FOS. Subject to a further appeal we are faced with conflicting first instance decisions on this important point of principle. The issues and the legal reasoning in this case warrant further scrutiny.

Functional approach

The first instance decisions on this point have taken what might be termed a functional approach, that is, to scrutinise the features of the FOS scheme in order to judge whether on balance this is a form of court or other competent tribunal for the purposes of the doctrine of merger. The features held to be of persuasive influence arguably point more happily to the opposite conclusion as made in this case. First, a summary and informal process is entirely compatible with a judicial process leading to a final and binding outcome. Secondly, the relative informality of the process, even one that permits mediation under the auspices of FOS, merely facilitates summary despatch of complaints: speedy and inexpensive despatch of complaints would be undermined if the process obliged reference of suitable complaints to an outside mediator. The fact that it is FOS itself which conducts the mediation is, at best, arguably a neutral feature if the outcome of mediation is a contract of settlement final and binding as between the parties by virtue of contract and whether that is with or without a FOS award itself directly enforceable by the court. It is the outcome which is significant rather than the process by which that has been achieved.

Significantly, a number of the features of the process appear to be modelled on court or other tribunal and appear to be judicial rather than administrative in nature: FOS has statutory power similar to, albeit more limited than, the court in order to obtain disclosure of relevant documents; it has control over admissible evidence and the way in which the process is conducted; and may summarily dispose of complaints lacking in merit. The scheme has authority by virtue of statute, by acceptance of authorised firms, and by the submission of complaints by complainants. However, FOS jurisdiction is broader than that of the English civil court in some senses but is also less extensive in other ways: it is broader in that the terms of reference extend beyond the common law to considerations of good practice and that which FOS considers to be fair and reasonable in all the circumstances. It is narrower to the extent of the scope of eligible complaints and complainants; significantly, it is narrower in terms of a financial limit to the awards made.

Complaints and causes of action

Cranston J also laid particular stress on the fact that the process is concerned with *complaints* rather than with causes of action and drew from this the legal conclusion that the doctrine of merger only applies to the latter. This arguably literal approach places weight on matters linguistic. The terminology adopted may simply be explained by the fact that the scheme is designed for individuals many of whom might be expected to be unfamiliar with legal terminology; some of whom may be deterred by an apparently legalistic approach. This risk is heightened by the fact that any engagement of legal advisors is effectively discouraged through the general restriction in recoverable legal costs. C*omplaint*, it is submitted, is an entirely natural term to use in the consumer context. In any event, assuming that the adoption of the word *complaint*, as distinct from *claim* or *cause of action*, is intended to have legal significance that choice is apt, and is explained by the breadth of the Ombudsman's jurisdiction: the draftsman may be assumed to have been alive to the need to select language which would clearly encompass matters which, even if proven, would not give rise to a cause of action in the legal sense of that term[19] but which, nevertheless, it was

[18] CPR Part 1 – the overriding objective being a guiding principle and core aspect of the rules of civil procedure.
[19] A cause of action may be described if not defined as a factual situation the existence of which entitles one person to obtain from the court a remedy against another person: Letang v. Cooper [1965] 1 QB 242.

intended could give rise to a falling short of good industry practice for the purposes of a remedy.[20] Accordingly, the choice is intentional in order to underline the broader scope of jurisdiction and awarding power available to FOS. In this way judgements made about the nature of good industry practice and what is fair and reasonable are relevant to determine the appropriate award and also to judge the performance standards to be expected from authorised firms in the first instance.[21]

As a matter of principle it might be said that the doctrine of merger is capable of application only to those complaints which constitute causes of action but that the doctrine cannot apply and accordingly has no relevance to those complaints which are incapable of giving rise to a civil remedy. It might separately be said that, given the decision- making process includes matters beyond strict law any decision beyond the limits of the law is incapable of binding the judgment of every other court for the purposes of estoppel by record or *res judicata*.[22] However, that line of argument overlooks the fact that awards made by FOS are enforceable as if they are orders of the county court.[23] The basis of the reasoning is thus weakened without consideration of the effect, if any, of the enforceability of FOS awards. The concept of a decision which binds all other competent courts is a central requirement of *res judicata*.

Res Judicata

The principle of *res judicata* is a form of estoppel, existing as such in two forms: (i) cause of action estoppel and (ii) issue estoppel and is part of a wider principle of public policy requiring the court to police abuse of the civil process. Cause of action estoppel, relevant in the context now discussed, prevents a party to an action from asserting or denying as against the other the existence of a particular cause of action when that existence or non- existence has been determined by a court of competent jurisdiction in previous litigation between the same parties. If the cause is successful it becomes merged into the judgment, hence reference to the doctrine of merger *transit in rem judicatam*; if unsuccessful the claimant is estopped *per rem judicatam*. This doctrine, as part of the wider policy concerning abuse of process, is sometimes referred to by the Latin maxim of *nemo debet bis vexari pro una et eadem causa*, meaning in simple terms the general principle of finality in legal proceedings to avoid unjust harassment of a party more than once for the same complaint.[24] For the purposes of the principle of *res judicata* it is irrelevant that the forum is domestic or private as between the parties such as an arbitrator. By contrast, what is significant is the extent of jurisdiction to make a final adjudication as distinct, for example, from an estimation or incidental expression of opinion on matters not fundamental to the outcome.[25]

The limit to the awarding power

Of significance in the legal analysis is the financial limit to the FOS awarding powers, currently set at £150,000, albeit coupled with a power of recommendation for sums in excess. There are three distinct possible outcomes which are all in varying degrees favourable to the complainant: (i) an award within the financial limit fully

[20] Cranston J referred to dicta in R (Heather Moor & Edgecomb Ltd) v. Financial Ombudsman Service Ltd [2008] EWCA Civ 642; [2008] BLR 1486 at paras 79-80 noting a distinction between causes of action and complaints. The context of these dicta is to stress that FOS is not obliged to apply the common law in all its particulars and this arguably supports the contention here put forward.

[21] Section 228 FSMA refers to a complaint being determined by what in the opinion of the Financial Ombudsman is fair and reasonable in all the circumstances. Section 229 deals with the awarding power and refers separately to the power to give directions to take such steps as the Ombudsman considers to be just and appropriate, whether or not a court could order those steps. The power to award compensation is concerned with a money sum which the Financial Ombudsman considers to be 'fair compensation'. Note that the more legalistic word 'damages' has not been adopted.

[22] Behrens v. Sieveking (1837) 2 My & Cr 602; Bradshaw v. M'Mullan [1920] 2 IR 412; Commissioners of Inland Revenue v. Sneath [1932] 2 KB 362 referring also to Reg v. Hutchings 6 QBD 300 and to Duchess of Kingston's Case (1776) 2 Sm. L.C. (7th edn) 767.

[23] Section 229 FSMA and Part III of Schedule 17.

[24] Per Diplock LJ in Thoday v. Thoday [1964] 1 All ER 341 at 352; and more recently noted by Lord Hoffmann in Arthur J. S. Hall & Co v. Simons [2002] 1 AC 615 at 701.

[25] Commissioners of Inland Revenue v. Sneath [1932] 2 KB 362 per Lord Hanworth MR at 381.

satisfying the complainant's alleged loss; (ii) an award within the financial limit which does not satisfy the complainant's alleged loss but where the full sum claimed is within that limit, for example, an award of £50,000 where the complainant has sought £100,000; and (iii) as in the second scenario but where the complainant's loss is alleged to be (as in this case) above the FOS financial ceiling, such as £500,000. In the first scenario, the issue is unlikely to ever become live: the complainant has no reason to commence legal proceedings and no potential remedy beyond that which he has received or may enforce by reference to the statutory scheme. It is likely to be a moot point whether the doctrine of merger prevents further process: by taking the same complaint before a court, albeit necessarily framing the complaint as a cause of action, would be an abuse of the process by reason of *res judicata*. The issue is acute for the parties concerned with complaints of the kind discussed here as the second and third scenarios. These difficulties arise simply because the FOS award has a relatively modest upper ceiling, albeit adequate for many insurance disputes, but unlikely to be adequate for many insurances, pension, life or other forms of investment. The key issue is whether there is any distinction properly to be made between the second and third scenarios and if so, on what legal basis is that distinction to be made?

It is of note that the complainant is not obliged to accept a favourable (or indeed an unfavourable) determination but that if he has done so FOS will make an enforceable award on a favourable determination. There is no right of appeal on the merits. Arguably a system for appealing is unnecessary because a complainant who is unhappy with the FOS determination is not obliged to accept that determination; he is entitled to reject the determination and for him there is no difficulty in concluding that any rights of action which he may possess are fully preserved. What then of the complainant who has the benefit of a favourable determination? There is no mechanism for partial acceptance, that is, to accept parts of the determination but to reject others, whether in terms of factual findings or in terms of the remedy. In the second scenario here considered the determination is wholly within the jurisdiction of FOS in a monetary sense. If the complainant accepts that determination an enforceable award will follow. It is significant that that award is enforceable as if an order of the county court and by this means becomes binding. If any rights of action on the same issues were preserved there would be a distinct possibility of a court reaching a decision in conflict with the FOS award, which more pertinently would then be in conflict with the prior (deemed court) order. That prospect is precisely what the principle of *res judicata* is designed to prevent. On the conclusions drawn in this case the complainants' acceptance is a somewhat unusual kind of acceptance signifying something short of a conclusive and final resolution. That outcome does not adequately deal with section 228 of FSMA which provides that on acceptance the determination becomes final and binding on both complainant and respondent. Assuming the reference to finality signifies no more than the conclusion of the FOS process (as determined by Cranston J) this does not deal with the specific reference to the outcome being binding. It is relevant to note that the determination is expressed to bind both complainant and respondent; the reference to complainant would be otiose if the outcome is intended to bind only the respondent. It is here submitted that in the second scenario acceptance of the determination gives rise to a bar to further complaint and court proceedings on the same matter.

Is then the position of the complainant in the third scenario any different? In this scenario the complainant faces a practical difficulty not shared by the second complainant because he has the benefit of a recommendation but unlike the sum awarded it is an uncertain benefit: he cannot be sure whether the respondent will accept that recommendation; nor is the recommendation subject to any acceptance; and it is not, of course, enforceable through the county court. He is faced with a dilemma: if he rejects the award he recovers nothing from the process and, moreover, he then faces a fresh, uncertain but certainly more expensive challenge through court proceedings. If he accepts the award he might only recover the sum awarded and this may fall well short of the entirety of his loss. His Honour Judge Pelling QC in *Andrews v. SBJ Consultants* [26] being alive to this problem referred to the complainant's ability to seek agreement with the respondent prior to making any decision on acceptance of the sum awarded, and to make his decision in the light of the response or the lack of it. No doubt a clear and unequivocal response indicating an intention on the part of the respondent to meet the sum recommended would ground a separate claim in contract although even then the complainant would need to commence fresh proceedings for breach of the discrete contract following any default by the respondent.

The alternative conclusions as a matter of law for the purposes of the issue whether further legal claim on the same factual matters is barred are either (a) decision by FOS which includes a recommendation, i.e. a sum in excess of the jurisdiction is simply insufficiently conclusive for *res judicata* purposes (notwithstanding that the sum awarded becomes enforceable through court process); or that (b) although only the sum included in the award takes effect as

[26] [2010] EWHC 2875 (Ch); [2011] Bus LR 1608.

if by court order acceptance of it then puts an end to any further right of claim on the same matter on *res judicata* principles (as held in Andrews v. SBJ Benefit Consultants Ltd)[27].

Key to the problem of legal analysis is the question whether or not a distinction may be properly drawn between the second and third scenarios here considered. A distinction might be said to exist between these two simply because it is not within the Ombudsman's power to award sums in excess of the financial limit and that the limit prevents the application of the doctrine of merger in the third scenario. The position with regard to the second scenario stands in marked contrast since the sums claimed fall entirely within the FOS jurisdiction. Distinguishing the second and third scenarios in this way is, however, not easily done. Assuming the matter of complaint gives rise to a single cause of action such a right of claim is not capable of being divided into financial layers of quantum, the first within the FOS financial jurisdiction and the second above such jurisdiction lying in the territory of 'mere' recommendation. Settlement of a cause of action is final whether or not that settlement sum falls short of the estimated quantum. Case law appears to support the conclusion that on acceptance of the award the complainant is prevented from commencing proceedings for the same matter and this is so whether or not the losses claimed exceed the financial limit of the FOS. The whole matter becomes *res judicata*. [28]

One practical solution might be to increase the financial limit on FOS jurisdiction. However, doing so might have the unintended consequence of undermining support for the scheme by authorised firms and might weaken the appetite for firms to conduct business in the UK consumer sector. Legal clarity on the point would in any event result in much welcome certainty in this subject area, to the benefit of consumers and authorised firms alike. The forthcoming judgment of the Court of Appeal will thus be of considerable interest.

[27] *Ibid*.

[28] Wright v. London General Omnibus Co. Ltd (1877) 2 QBD 271; Clarke v. Yorke [1882] 52 LJ Ch 32 although pre dating complaint schemes under FSMA or otherwise. In both cases compensation was awarded to the party injured and accepted by him which fell short of the full extent of losses claimed; the limitations in compensation were as a result of limits in the court's financial jurisdiction but acceptance put an end to any right of further claim.