CLIFFORD CHANCE

Client briefing
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Claims against banks: another factual triumph

The banking industry's run of success in defeating misselling claims brought by customers in the English courts continued in *Bank Leumi (UK) plc v Wachner* [2011] EWHC 656 (Comm). Again, the customer failed to make out the factual basis of her claim and, as a result, was unable to recover from the bank losses made in foreign exchange dealing.

Springwell v JP Morgan, *Wilson v MF Global*, *San Marino v Barclays* and other cases have all involved claims by customers of financial institutions to recover money lost in investments or trading. In each case, the customer has been unsuccessful because, essentially, the customer has failed to demonstrate the factual basis upon which the claim was constructed. *Wachner* can now be added to that list.

Wachner involved the former CEO of a Fortune 500 company who was seeking to recover losses made in earlier foreign exchange dealings. To do this, she started trading in reverse knock in options, or RKIs. These are like vanilla currency options but, in addition to the option strike price, they include a knock in price. Unless the relevant exchange rate hits the knock in price before maturity, the option is not exercisable. So, for example, one RKI was entered into when the €/$ exchange rate was 1.5319. The option had a strike price of 1.50, but a knock in price of 1.57. If the exchange rate remained below 1.57 through to maturity, the option was not exercisable; if the exchange rate went above 1.57 at any time before maturity, the option was activated and could be exercised at maturity - and, obviously, the option would be exercised provided that the exchange rate was still above 1.50 at maturity.

Unfortunately, the customer's trading over the highly volatile last four months of 2008 resulted in losses of over $13 million.

Misrepresentations

The bank's customer alleged that she traded RKIs because of three misrepresentations by the bank. These misrepresentations were that: RKIs were less risky than plain vanilla options; the risks on RKIs could be managed indefinitely by pushing out their expiry dates at zero cost; and when the customer traded matched pairs of options (straddles or strangles), the bank would only calculate margin by reference to one side of the trade.

All these allegations failed on the facts. The judge considered that RKIs were in themselves less risky than vanilla options because of the barrier to exercise. The way the customer chose to trade RKIs may have increased the risk, but that was not inherent in RKIs. The representation was therefore correct. The judge also found that no misrepresentations had been made about pushing out the expiry dates, and that any representation about margin calculations was only a statement of the bank's existing policy, not a commitment that the policy would always remain the same.

The customer also argued that the bank owed a general duty of care to advise, but that argument failed too. The bank's terms of business that governed the relationship stated that the bank was providing an execution only service. The terms of business went on that the bank had no duty to advise on the merits or suitability of an investment unless the bank entered a specific agreement to do

Key Issues

- **Representations allegedly by a bank were true, not made or did not carry the implication alleged**
- **The bank took reasonable care in classifying the customer under the FSA's rules**
- **Those who enter sophisticated transactions must look after their own interests**

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so. The judge considered that a specific agreement for these purposes did not have to be in writing, but he still could not find anything that amounted to a specific agreement to provide advice.

The judge followed the approach in *Springwell* and *Wilson* in distinguishing between true advice and discussions with a trader or salesman that amounted to swapping market hunches or exchanging ideas, often spontaneous or off the cuff. Discussions of this latter sort might lead to a low level duty of care not to make negligent misstatements or not to recommend a highly risky trade without pointing out the risks, but would not generate a general obligation to advise. The customer's discussions with the bank's traders in *Wachner* were distinctly of the spontaneous sort rather than considered advice as to suitability.

Misclassification

As in *Wilson*, the customer also alleged that she had been wrongly classified for the purposes of the FSA's Conduct of Business Rules as an intermediate customer rather than as a private customer. This, she alleged, gave her a cause of action under section 150 of the Financial Services and Markets Act 2000.

Again, the allegation failed on the facts. The bank's obligation was to take reasonable care in making its classification rather than to reach an objectively correct classification. The judge decided that the bank had taken reasonable care. In particular, the judge accepted that it was reasonable for the bank to rely on information from an employee of its US affiliate, who had been the customer's account manager for a number of years, even though she was not a foreign exchange trader herself. The bank had regard to relevant criteria, and there was no requirement to cross-check information with the client, or to interview the client to establish her experience in the foreign exchange markets.

The bank's original, and correct, classification of the customer before November 2007 enabled her to be "grandfathered" under the new, MiFID, regime as an elective professional client. The judge considered that the bank was only obliged to reconsider its classification if it knew that its customer no longer met the required conditions for her classification; it was not enough that it ought to have known that to be the case. In any event, nothing should have led the bank to reclassify the customer.

Conclusion

English courts remain clear that just because a loss is suffered in financial dealings, it is not necessarily the fault of the more experienced party. Financial institutions do not guarantee the success of investments. The courts also look with scepticism upon claims made by parties who voluntarily entered into sophisticated transactions that they did not understand what they were doing. Consumers who properly rely on advice can expect protection, but more sophisticated parties who trade in large amounts must expect to look after themselves.