Selling Complex Financial Instruments to Non-Retail Clients

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Introduction

1. Since the global financial crisis there has been an increase in claims against financial institutions who distribute complex financial products. Many of these claims have been brought by retail investors for misselling complex products such as collateralised debt obligations (CDOs).

2. In Australia there are very few decided cases which have considered the liability of financial institutions to sophisticated investors who have invested in their complex financial products. Banks and arrangers operate on the basis that sophisticated investors understand the product and the risks involved in investing, and that those investors rely on their own assessment and that of their advisers in deciding to invest. The arm's length nature of the relationship between financial institutions and investors, the inclusion of express contractual disclaimers, exclusion clauses and non-reliance clauses operate to limit the liability and scope of duty those institutions owe to those investors.

3. The purpose of this paper is to explore the liability of financial institutions who sell these complex financial products.

Background

4. In March 2012, an appeal by the German state-owned international commercial bank Landesbank Baden-Wurttemberg was heard in the Second Circuit of the US Court of Appeals in New York. It was an appeal from the decision of a trial judge to dismiss Landesbank's claim against Goldman Sachs and an investment adviser TCW Asset Management Co. The case involved a CDO called "Davis Square Funding VI", collateralized by residential mortgage-backed loans which were underwritten, managed and marketed by Goldman Sachs and TCW at the height of the housing boom. Landesbank lost $37 million from investing in the CDO's

and alleged that Goldman Sachs and TCW should have foreseen the housing market implosion.

5. Landesbank based its claims on common law fraud, negligent misrepresentation and unjust enrichment in the marketing and selling of the CDOs. The claim did not allege any particular motive for committing the fraud other than the profit motive, but alleged the concealment of material facts. Landesbank alleged that Goldman Sachs concealed the true quality of the mortgages from the rating agencies when it obtained the triple-A credit rating, knew what information the ratings agencies and the US Securities and Exchange Commission had about the quality of the underlying mortgages and used the fraudulently obtained credit ratings in marketing materials for the CDO.[1] Landesbank also alleged that Goldman Sachs profited unjustly from the CDOs by charging an excessively high purchase price and advisory fees for the notes and purchasing billions of dollars of credit default swaps to insure itself against the collapse of the mortgage-backed securities underlying the CDO notes.[2]

6. Landesbank asserted that had it known about the poor quality of the underlying mortgages it would not have invested in the CDOs.

7. On 19 April 2012, the Appeal Court dismissed the appeal upholding the trial judge's decision to dismiss Landesbank's claim for failing to adequately state a claim upon which relief could be granted.[3]

8. From an Australian law perspective, the interesting aspect of this appeal is the relevance of the disclosures made by Goldman Sachs in the CDO Offering Circular and the sophisticated nature of Landesbank which was critical to the failure of the negligent misrepresentation claim.

9. To establish negligent misrepresentation in a commercial transaction under New York law, it is necessary to establish a special relationship of trust and confidence between the parties such that the party relies upon on the person's special expertise. The trial judge dismissed the negligent misrepresentation claim as Landesbank had failed to adequately plead justifiable

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[1] *Landesbank Baden-Wurttemberg v Goldman, Sachs & Co and TCW Asset Management Co.*, 10 Civ. 7549, USDC New York, Memorandum & Order, 28 September 2011, p 5-6.

[2] *Landesbank Baden-Wurttemberg v Goldman, Sachs & Co and TCW Asset Management Co.*, 10 Civ. 7549, USDC New York, Memorandum & Order, 28 September 2011, p 5-6.

[3] *Landesbank Baden-Wurttemberg v Goldman, Sachs & Co and TCW Asset Management Co.*, 11-4443, US Court of Appeals 2nd Circuit New York, Summary Order, 19 April 2012, p 3-5.

reliance as it had not dealt with the disclosures made by Goldman Sachs in the CDO Offering Circular. Specifically:

(a) the Offering Circular disclosed details of the risks inherent in the CDOs, disclaimed both the existence of any special relationship of trust or confidence between Landesbank and Goldman Sachs and any special expertise on the part of Goldman Sachs. It disclaimed a fiduciary or advisory role;[4]

(b) the Circular warned investors to consider and assess for themselves the likely level of defaults of the collateral assets, as well as the likely level and timing of recovering on the collateral assets;[5]

(c) the Circular also required Landesbank to represent that it was a sophisticated investor, it understood investing in the CDOs involved the risk of losing its entire investment, it had access to the financial information about the underlying mortgage-backed securities including an opportunity to ask questions and request additional information about the CDOs, it had evaluated the purchase price of the CDOs with a full understanding of the risks involved and that it had consulted with its own experts and made its own investment decisions.[6]

10. The Appeal Court held that the relationship between Landesbank and Goldman Sachs and TCW was that of buyer and seller in a standard arm's length transaction and that Landesbank had sufficient expertise to evaluate the risks of investing in the CDOs.

11. This highlights the distinction banks make between selling financial products to retail and sophisticated clients. It is generally not the aim of the Corporations Act 2001 (Cth) to prohibit the sale of complex financial products. These products are allowed to be sold provided the marketing material, Product Disclosure Statements and other disclosure documents contain detailed information on how the product works and the material risks and benefits, so that the investor may make a fully informed decision. There is also an increasing trend towards imposing obligations on the seller or marketer to be satisfied that the investor understands the

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[4] *Landesbank Baden-Wurttemberg v Goldman, Sachs & Co and TCW Asset Management Co.*, 10 Civ. 7549, USDC New York, Memorandum & Order, 28 September 2011, p 3-4.

[5] *Landesbank Baden-Wurttemberg v Goldman, Sachs & Co and TCW Asset Management Co.*, 10 Civ. 7549, USDC New York, Memorandum & Order, 28 September 2011, p 3-4.

[6] *Landesbank Baden-Wurttemberg v Goldman, Sachs & Co and TCW Asset Management Co.*, 10 Civ. 7549, USDC New York, Memorandum & Order, 28 September 2011, p 3-4.

risks involved and has a minimum level of training, experience and understanding of how the product works (such as recent reforms concerning CFDs).

12. As products become more complex, investors are often required to sign contracts that contain terms as to non-reliance, disclaimers and sophistication. These terms are designed to limit the seller's liability and to transfer risk to the investor. The investor exercises its own business judgement to determine the merits of buying the product, occasionally assisted by its own financial adviser or internal analysis upon which they rely to advise on the risk and benefits of the product.

13. The issue then becomes - in the sale of complex financial products is it solely a case of "caveat emptor" or buyer beware? The purpose of this paper is to explore that issue by providing an overview of some the key statutory and general law causes of action, and to identify the extent to which the courts will be influenced by not only the steps taken by banks to protect themselves and limit their liability but the matters investors take into account in deciding to invest.

Complex financial products

14. There is no universally accepted judicial meaning of the term "complex financial product". The Corporations Act uses the defined term "financial product" which is defined to mean a facility through which, or through the acquisition of which, a person makes a financial investment.[7] An investor "makes a financial investment" if:

> "(a) the investor gives money or money's worth (the contribution) to another person and any of the following apply:
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> (i) the other person uses the contribution to generate a financial return, or other benefit, for the investor;
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> (ii) the investor intends that the other person will use the contribution to generate a financial return, or other benefit, for the investor (even if no return or benefit is in fact generated);
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> (iii) the other person intends that the contribution will be used to generate a financial return, or other benefit, for the investor (even if no return or benefit is in fact generated); and

> (b) the investor has no day-to-day control over the use of the contribution to generate the return or benefit."[8]

15. The language used to for the general definition of "financial product" is of such wide import that it is sufficiently capable of encompassing a "complex financial product". In any case, a "complex financial product" would plainly be a subset of "financial product" distinguished by its complexity. Insofar as a "financial product" specifically includes a derivative,[9] a "complex financial product" could include a complex derivative.

16. In the 2009 OECD Journal on Financial Market Trends, the following observation was made in the course of discussing regulatory issues related to financial innovation:

> "Some new products seem to be complex, but actually can be decomposed into a few simple payment streams that are themselves combinations of even more basic components. But some other new products are extremely complex. They may be based on entirely new processes; sometimes new organisational structures are also involved (*e.g.* structured investment vehicles and conduits), all of which can result in substantially greater levels of complexity and opacity than for similar, more traditional products. New financial products that are tailored to specific clients are often based on complex derivatives and place considerable reliance on market liquidity, arrangements that can tend to make the balance sheet vulnerable in times of stress."[10]

17. In various interlocutory decisions in connection with current legal proceedings before the Federal Court of Australia in *Wingecarribee Shire Council v Lehman Brothers Australia Limited* NSD 2492/2007 (and the external administration of Lehman Brothers Australia Limited itself), the Court referred to:

> "...products sold by the company such as bonds, collateralised debt obligations, residential mortgage-backed securities, credit default swaps, and other associated market investments. The collateralised debt obligations and similar financial

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[7] Corporations Act 2001 (Cth) s 763A(1).

[8] Corporations Act 2001 (Cth) s 763B.

[9] Corporations Act 2001 (Cth) s 764A.

[10] S A Lumpkin, "Regulatory Issues Related to Financial Innovation", Financial Market Trends - OECD Journal, No 97 Vol 2009/2, page 18.

instruments were highly complex products. Their true nature may be difficult to understand and may still be unravelling in the financial markets following, among other things, the collapse of Lehman Brothers' parent company in the United States. I will refer to these as "complex financial products".[11]

18. The common feature of these products is that they are innovative and require a sophisticated understanding of how they are priced, operate and the overall risks involved. They are generally marketed to sophisticated and wholesale investors.

Non-retail sophisticated or wholesale clients

19. The Corporations Act establishes a regulatory framework which distinguishes between retail, wholesale, sophisticated and professional investors.

20. Generally non-retail "sophisticated" (in the plain and ordinary sense) investors might be described as investors who "are able to look after themselves and do not need the protection which a disclosure document would afford".[12] The characteristics of a non-retail client can be summarised as follows:

(a) professional investors with sufficient knowledge, experience and advice to make their own evaluation of the merits and risks of a complex financial instrument;

(b) solely responsible for making their own independent appraisal and investigation of the product, its risks and benefits;

(c) fully aware that it may make a loss (including a significant amount) on its investment and experience delays in achieving a return on its investment

21. Under the Act there is a distinction between "retail clients" and "wholesale clients". A "wholesale client" is defined as follows:

(a) a financial product or a financial service is provided to, or acquired by, a person as a wholesale client if it is not provided to, or acquired by, the person as a retail client;[13]

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[11] *Singleton in the matter of Lehman Brothers Australia Limited (in liquidation)* [2010] FCA 1491 at [2].

[12] Ford's Principles of Corporations Law, 14th edition, [22.150], p 1149.

[13] Corporations Act 2001 (Cth) s 761G(4).

(b) a financial product or a financial service (which is not a general insurance product, a superannuation product or an RSA product) is provided to a person as a retail client unless:

(i) the price for the provision of the financial product or the value of the financial product equals or exceeds $500,000;[14] or

(ii) the financial product or a financial service is provided for use in connection with a business (that is not a small business);[15] or

(iii) the financial product or a financial service is not provided for use in connection with a business and the person who acquires the product or service gives to the provider of the product or service written certification from a qualified accountant that the person has net assets of at least $2.5 million or has a gross income for each of the last 2 financial years of at least $250,000.[16]; or

(iv) the person is a professional investor, which is defined to include a financial services licensee, a body regulated by APRA (such as a bank), a person who controls at least $10 million, a listed entity.[17]

22. Section 761GA defines "sophisticated investor". The provision states that a financial product or a financial service in relation to a financial product is not provided by a financial services licensee to a person as a retail client if, amongst other things:

> "the licensee is satisfied on reasonable grounds that the other person (the ***client***) has previous experience in using financial services and investing in financial products that allows the client to assess:
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> (i) the merits of the product or serve; and
>
> (ii) the value of the product or service; and

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[14] Corporations Act 2001 (Cth) s 761G(7)(a); Corporations Regulations 2001 (Cth) regs 7.1.18 (price of investment-based financial products), 7.1.19 (value of investment-based financial products), 7.1.22 (value of derivatives).

[15] Corporations Act 2001 (Cth) s 761G(7)(b); "small business" means a business employing less than (a) 100 people if the business is or include the manufacture of goods, (b) otherwise 20 people: s 761G(12).

[16] Corporations Act 2001 (Cth) s 761G(7)(c); Corporations Regulations 2001 (Cth) reg 7.1.28.

[17] Corporations Act 2001 (Cth) s 761G(7)(d). For definition of "professional investor" see s 9.

(iii) the risks associated with holding the product; and

(iv) the client's own information needs; and

(v) the adequacy of the information given by the licensee and the product issuer."[18]

23. The statutory definition of "sophisticated investor" also includes the limb in paragraph (c) that "the financial product or service is not provided for use in connection with a business" by which it is intended that this type of non-retail investor is not carrying on business as a wholesale dealer.

24. The appropriateness of the distinction between wholesale and retail clients and the definition of a sophisticated wholesale investor is currently under review by the Federal government as part of the "Future of Financial Advice" reforms. This review follows the global financial crisis during which clients, who qualified as "sophisticated investors" under the current statutory definition but did not have the necessary experience investing in complex financial products, were able to access these on the wholesale market without regulatory protection and made substantial losses.

25. The financial product disclosure obligations under Part 7.9 of the Corporations Act (failure to provide a Product Disclosure Statement (PDS), complying with the contents of a PDS) only apply in relation to retail clients and not "wholesale clients"[19] (ie non-retail clients). For example, the banker only has an obligation under section 1012A to give to a person a PDS if the banker provides "financial product advice"[20] that consists of or includes a recommendation that the person acquire the "financial product"[21] and the financial product advice is provided to the person as a retail client. The bank also has an obligation under sections 1012B and 1012C to give a person a PDS when it offers to issue or offers to sell a "financial product"[22] to a person if the financial product is to be issued or sold to that person as a retail client.

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[18] Corporations Act 2001 (Cth) s 761GA(d).

[19] Sections 761G and 761GA.

[20] Section 766B (meaning of "financial product advice").

[21] These disclosure obligations do not apply to financial products that are securities: section 1010A(1).

[22] These disclosure obligations do not apply to financial products that are securities: section 1010A(1).

Overview of causes of action

26. Aggrieved sophisticated investors typically rely upon the following causes of action in bringing a claim against the sellers and marketers of these products:

(a) breach of contract, either express or implied terms;

(b) breach of a duty of care arising under the general law of negligence;

(c) breach of fiduciary obligations; and

(d) breaches of the statutory obligations (under the Corporations Act and the ASIC Act) not to engage in misleading or deceptive conduct.

27. A sophisticated investor may bring these claims against a bank in its capacity not only as a seller of complex financial products but also as an adviser who relies on the advice given by the bank in deciding to acquire the product. The liability of financial planners or advisers who are connected to these banks either as employees or authorised representatives raise for considerations other duties such as the obligation in s945A of the Corporations Act to have a reasonable basis for any investment advice or recommendation. That duty is beyond the scope of this paper. The expectation at the core of the causes of action against banks for the straight marketing and selling of these products, where they are not responsible for providing any financial advice, is that those banks ought to have disclosed and explained in more detail the nature of the complex and risky financial products they designed, manufactured and sold, and that they had a duty to warn those investors not to invest if they had formed the view that the products were too complex and not suitable investments for their purposes. Occasionally the allegation is that the sellers themselves did not truly understand the underlying risk in products such as CDOs.

Contractual Claims

28. Providers of complex financial products generally seek to contractually limit their liability by exclusion clauses, disclaimers and non-reliance clauses. These clauses emphasise that they have not advised on the appropriateness of the investment. They contain acknowledgments that the investor has relied upon their own advice or assessment and recommends that the investor should obtain their own legal, financial and taxation advice. They contain an acknowledgment that the investor has understood the risks involved with the investment.

29. These clauses are designed to fundamentally characterise the relationship between the banks and investor as an arm's length relationship of buyer and seller, each acting in their own self interest and to limit the ability of the investor to rely upon the conduct of the bank in deciding to invest.

30. Absent misleading and deceptive conduct or lack of disclosure, these clauses are generally effective at excluding liability.[23] Although each claim will be highly fact specific, where sophisticated investors are involved, generally it would be reasonable for the seller to accept that the investor has been independently advised or has undertaken their own fully informed assessment in deciding to invest in the product.

31. The contract may require the bank to act fairly and reasonably or in accordance with the standards of a diligent and prudent banker. Conceivably, in the context of selling complex financial products and the allocation of the risks involved, the contract may also stipulate other specific obligations such as advising on certain aspects of the transaction, monitoring the investments or aspects of the complex financial product, providing up-to-date accurate information about the product.

32. Some of the recent claims arising out of the global financial crisis have relied upon implied contractual terms in the contract between financial institutions and investors imposing obligations on the financial institutions to advise them that the products were unsuitable for them or to provide a level of enhanced disclosure beyond their obligations in the Corporations Act. An implied term will not be recognised in a contract unless: (1) it is reasonable and equitable; (2) it is necessary to give business efficacy to the contract; (3) it is so obvious that 'it goes without saying'; (4) it is capable of clear expression; and (5) it does not contradict any express term of the contract.[24]

33. In the Federal Court proceedings in *Wingecarribee Shire Council v Lehman Brothers Australia Limited*, in the context of the sale of CDOs, the claimants allege that Lehman Brothers failed to advise them that the CDOs were derivatives and generally unsuitable for investment by local governments or persons who were not sophisticated investors, and that the CDOs they had purchased were exposed to the subprime mortgage market in the United States and of the

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[23] *Butcher v Lachlan Elder Realty Pty Ltd* (2004) 218 CLR 592 at [49]-[76]; *Campbell v Backoffice Investments Pty Ltd* (2009) 238 CLR 304 at [29]-[31].

[24] *BP Refinery (Westernport) Pty Ltd v Hastings Shire* (1977) 180 CLR 266 at 283; *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337.

risks associated with such an investment.[25] Broadly speaking, it is alleged that these obligations are to be implied into the sale contract between Lehman Brothers and the Council such that Lehman Brothers had an obligation to ensure that the CDOs were a suitable investment for the Councils.

34. The difficulty with implying these types of obligations in the contract between the bank and the investor is that often these obligations are inconsistent with the express disclaimers and non-reliance clauses referred to above. The courts will be reluctant to impose obligations on a bank to warn and recommend against the investment in the face of these contractual acknowledgments by the investor, especially where the buyer is non-retail and has obtained their own advice.

35. Additionally, such obligations are inconsistent with the proper characterisation of the relationship between the bank and the investor which is an arm's length relationship between buyer and seller (as was evident in the *Landesbank* case), as opposed to that of a financial planner or adviser. The obligations of a financial planner or adviser are clear, whether it be under contract, duty of care or s945A of the Corporations Act. The adviser must understand the personal circumstances of the investor and to give advice and recommendations that are appropriate having regard to those individual circumstances. Those obligations are different to the general relationship between buyer and seller in these circumstances. The bank does not undertake an investigation of the investors individual circumstances and so is not and cannot be in a position to determine whether the product is appropriate to the investors individual needs and circumstances.

36. This is analogous to the stockbroker cases where generally the obligation is to execute client orders. This was dealt with recently in *Eric Preston Pty Ltd v Euroz Securities Limited* [2011] FCAFC 11, which concerned a dispute between client and stockbroker. The client sought to impose in the retainer agreement with the stockbroker a term that the stockbroker had a duty to advise in relation to financial credit products offered by third parties which may have been used by the client to assist in the purchase of shares. The client asserted that the stockbroker

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[25] *Singleton in the matter of Lehman Brothers Australia Limited (in liquidation)* [2010] FCA 1491 at [8]. There are also other allegations concerning breached its duties, as a fiduciary of those creditors, by investing their funds in collateralised debt obligations, either originated by members of the Lehman Brothers group of companies, or third parties, failed to avoid conflicts of interest that may have arisen from such a position, engaged in conduct that was misleading or deceptive or likely to mislead or deceive in contravention of s 12DA of the Australian Securities Investment Commission Act 2001 (Cth), or the Corporations Act, was in breach of contract, was in breach of its fiduciary duties; or was negligent.

ought to have advised them against entering into securities lending agreements as a means of financing the acquisition of equities.

37. The Full Federal Court held that there was no express or implied agreement to that effect. The Court held:

(a) "...the duty of a stockbroker is to execute the client's orders. Stockbrokers are not duty bound in law to give advice, but if they do so, they must of course provide the advice in a competent and honest way. The duties of a stockbroker at general law may be added to or varied by special agreement or by the circumstances of the case";[26]

(b) "absent some evidentiary basis for inferring the voluntary undertaking by the stockbroker of a duty to advise, there is no duty to do so. Importantly, any duty to advise does not arise from the relationship alone but may arise from the circumstances of a particular case. The circumstances may consist of an express undertaking or facts and circumstances which give rise to an implied obligation to advise the client";[27]

(c) "the duty for which [the client] contends is a duty to provide advice on a matter which does not ordinarily relate to the nature or subject matter of the orders which a broker is required to undertake for its client. This is not a case in which it is said that the broker was under a duty to advise as to the wisdom of the purchase of a particular stock or share on the ASX. Rather, the duty is said to be to advise the client about the nature of a financial product which the client was considering using in order to facilitate the purchase of stocks or shares."[28]

38. The Court, however, did recognise that such a duty may arise in the circumstances of a particular case as a breach of contract or tortious duty.[29] Although difficult, depending upon the nature of the relationship between the bank and the investor, a court may be prepared to imply a term into their contract that the bank would be under a duty to advise the investor whether or not the product was suitable for them. This will depend on the nature of the

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[26] *Eric Preston Pty Ltd v Euroz Securities Limited* [2011] FCAFC 11 at [160].

[27] *Eric Preston Pty Ltd v Euroz Securities Limited* [2011] FCAFC 11 at [161].

[28] *Eric Preston Pty Ltd v Euroz Securities Limited* [2011] FCAFC 11 at [164].

[29] *Eric Preston Pty Ltd v Euroz Securities Limited* [2011] FCAFC 11 at [165].

relationship between the bank and investor, whether it was a long standing customer of the bank, whether the customer came to rely on the bank for advice over time, whether through that previous relationship the bank came to understand investor's individual needs and financial circumstances and investment strategies.

39. This explains why it is critical for those generally involved in the distribution of complex financial products to properly consider the contractual allocation of risk with investors. It is important that the contractual obligations and risks of the parties are made very clear at the outset, and if there is an ongoing relationship for that contract to be constantly renewed and refreshed. This is also important in the context of whether a Court would be prepared to impose a duty of care on the bank, which I now consider.

Breach of a duty of care arising under the law of negligence

40. For an investor to succeed in any negligence claim against a bank, they must establish the following elements:

(a) a duty of care owed by the bank to the investor;

(b) a breach of that duty;

(c) a causal connection between the breach of duty and loss or damage suffered as a result of the breach; and

(d) the damage is not too remote from the breach.

41. A financial institution can be liable for a failure to provide information or advice when it ought to have realised that the investor was relying on him or her to provide more than was actually imparted.[30] In *Delmenico v Brannelly* [2008] QCA 74, the respondent lent $100,000 upon the security of two promissory notes from Bayshore Mezzanine Pty Ltd. The appellants had proposed this investment to the respondent. However, administrators were appointed to Bayshore on 6 December 2005. The promissory notes issued by Bayshore were valueless and the respondent recovered none of the principal of his loan. In addition to an action under section 12DA of the ASIC Act, the respondent also advanced an alternative claim for damages for loss suffered by reason of negligent advice by the appellants. The appeal was based principally on the contention that the respondent had acted, not upon advice or information provided by the appellants, but upon an erroneous understanding of the structure of the

[30] RP Balkin & JLR Davis, *Law of Torts*, 4th edition, 2009 at [13.34].

investment for which he alone was responsible. The appellants contended that the findings of negligence which the learned primary judge made against the appellants were not open on the respondent's pleaded case.

42. The Court held that:

> "The defendants have failed in their duty of care to the plaintiff by failing to advise him about the nature of the security being offered and by misrepresenting or failing to understand the true nature of the security and misleading the plaintiff in the correspondence. It was a clear case of the first defendant not understanding his product."[31]

43. However, the courts will be unwilling to recognise a general law duty of care if the relationship between the bank and the investor is governed by an express contractual agreement between them and the duty of care is covered by such an obligation under the contract. In *Privy Council in Downsview Nominees Ltd v First City Corporation Ltd* [1993] 2 WLR 86 at 99, Lord Templeman (in delivering the judgment of their Lordships) said:

> "The House of Lords has warned against the danger of extending the ambit of negligence so as to supplant or supplement other torts, contractual obligations, statutory duties or equitable rules in relation to every kind of damage including economic loss..."

44. In *Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd* [1986] 1 AC 80, Lord Scarman said at 107:

> "Their Lordships do not believe that there is anything to the advantages of the law's development in searching for a liability in tort where the parties are in a contractual relationship. This is particularly so in a commercial relationship."[32]

45. In *Simms, Jones Ltd v Protchem Trading NZ Ltd* [1993] 3 NZLR 369 at 377, Tipping J said:

> "Where parties are in a contractual relationship, it will, in the absence of special circumstances be a normal, natural and reasonable inference that they intend and expect their relationship to be governed solely by the contract and the law relating

[31] [2008] QCA 74 at [52].

[32] See also *Politarhis v Westpac Banking Corporation* [2008] SASC 296 where the Court declined to find that the bank owed the customer a duty of care to avoid causing financial loss.

to contractual obligations. If an asserted obligation does not arise under the express terms or by clear and necessary implication, a party to the contract can reasonably expect the Court to take the view that there is no such obligation. If the obligation does arise expressly or by implication there is no need to rely on the suggestion that some concurrent or coexistent obligation of the same kind also arises in tort."

46. In Australia it has been well recognised that in case of economic loss, the contract generally determines the content of the duty of care.[33] The courts are reluctant to attenuate a contractually agreed allocation of risk and responsibility.[34]. In *Astley v Austrust*, Gleeson CJ, McHugh, Gummow and Hayne JJ said:

> "The implied term of reasonable care in a contract of professional services arises by operation of law. It is one of those terms that the law attaches as an incident of contracts of that class. It is part of the consideration that the promisor pays in return for the express or implied agreement of the promisee to pay for the services of the person giving the promise. Unlike the duty of care arising under the law of tort, the promisee in contract always gives consideration for the implied term. And it is a term that the parties can, and often do, bargain away or limit as they choose. Rather than ask why the law should imply such a term in a contract for professional services, it might be more appropriate to ask why should the law of negligence have any say at all in regulating the relationship of the parties to the contract? The contract defines the relationship of the parties. Statute, criminal law and public policy apart, there is no reason why the contract should not declare completely and exclusively what are the legal rights and obligations of the parties in relation to their contractual dealings. The proposition that, in the absence of express agreement, tort and not contract regulates the duty of care owed by a professional person to a person hiring the professional services is inconsistent with the historical evolution of professional duties of care which, until recently, could be the subject of action only in contract. ..."[35]

47. Therefore the general rule is that the scope and content of a bank's duty of care to an investor will be co-extensive with its contractual obligations. The scope of the duty will be defined by

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[33] *Council of the Shire of Sutherland v Heyman* (1985) 157 CLR 424.

[34] *Johnson Tiles Pty Ltd v Esso Australia Pty Ltd* [2003] VSC 27.

[35] (1999) 97 CLR 1 at [47]-[48].

the terms of the contract. The fact that the parties have turned their mind to allocating risk under the contract by agreeing to exclusion and disclaimers clauses and acknowledgments that the investor relied on their own risk analysis, would count against a court imposing a duty of care on an investor not to invest in the product or to warn them the product was inappropriate for them.

48. There are some recent authorities in the duty to warn cases that apply to solicitors that may challenge the duty of banks in the future. For instance, in *Riz v Perpetual Trustee Australia Ltd*, Brereton J of the Supreme Court of New South Wales [2007] NSWC 1153 stated:

> "The prevailing position is that the scope of a solicitor's duty of care is not limited to the terms of the retainer but, depending upon the circumstances of the particular case, may require the taking of positive steps beyond the specifically agreed professional task or function, where these are necessary to avoid a real and foreseeable risk of economic loss being sustained by the client".

49. Any such trend will need to overcome the notion that the bank and the client are fundamentally in an arm's length relationship, each seeking to protect their own commercial interests. As was stated in *National Australia Bank v Mark Patrick Mullins* [2006] ACTSC 116, Harper M at [80] addressed the issue of a bank's duty of care in relation to commercial advice:

> "On the question of the duty owed by a bank to a borrower, I apply the principle stated by Meagher JA in Beneficial Finance Corporation Ltd v Karabas (1991) 23 NSWLR 256 at 277, where his Honour said, referring to earlier authority, that there is no duty on a financier to provide a borrower with any commercial advice, although if any such advice was tendered the financier might be found to have assumed a duty of care. The question was considered more recently by Barrett J in Timms v Commonwealth Bank of Australia [2004] NSWSC 76. His Honour noted that cases in which a Bank lending to a customer assumed a fiduciary liability were rare, and arose only where the Bank’s role extended beyond that of finance provider into the area of advice. In the case before his Honour, the fact that the Bank had information suggesting that the customer was paying too much for a business or property and that the purchase might prove unprofitable was of itself insufficient to give rise to such responsibility. His Honour found also that the Bank was not liable in tort, there being no duty of care on the part of a bank lending to a customer in a normal commercial transaction."

50. In the negligence claim in *Timms v Commonwealth Bank of Australia*, Barrett J rejected the claim on the basis that the relationship between the bank and the Timms parties was of an arm’s length character in that each had its own interest, independently of the other, in making some form of inquiry into and assessment of the commercial matters in question and the relevant "form of neighbourhood that lies at the heart of modern conceptions of duty of care" was not present.[36]

51. In the absence of the defining contractual arrangements between the parties, the courts have identified a number of factors which are weighed up at the point immediately prior to the alleged breach of duty for the purposes of determining whether a duty of care exists.[37]

Vulnerability

(a) The vulnerability of the claimant "has emerged as an important requirement in cases where a duty of care to avoid economic loss has been held to have been owed".[38] Vulnerability refers to the vulnerability of the claimants to incurring loss by reason of a respondent's conduct, as well as the likelihood that the claimant would suffer loss if reasonable care was not taken.[39] The question is whether the claimant had any capacity to protect itself against the risk of the harm or loss.[40] If the claimant has taken, or could have taken, steps to protect itself from the respondent's conduct and was not induced by the respondent's conduct not to take such steps, the law will not step in and impose a duty on the respondent to protect the claimant from pure economic

(b) In *Esanda Finance Corporation Ltd v Peat Marwick Hungerfords*, Toohey and Gaudron JJ held that since the financier could have taken its own advice about the company's position, it was not reasonable for it to depend on the auditor's

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[36] *Timms v Commonwealth Bank of Australia* [2004] NSWSC 76 at [174].

[37] *Perre v Apand* (1999) 198 CLR 180 at [112] per McHugh J, [201] per Gummow J, [336] per Hayne J

[38] *Woolcock Street Investments Pty Ltd v CDG Pty Ltd* (2004) 216 CLR 515 at [23] per Gleeson CJ, Gummow, Hayne and Heydon JJ.

[39] *Perre v Apand* at [11] per Gleeson CJ, at [104], [118] per McHugh J, at [416] per Callinan J; *Woolcock Street Investments Pty Ltd v CDG Pty Ltd* (2004) 216 CLR 515 at [23] per Gleeson CJ, Gummow, Hayne and Heydon JJ.

[40] *Esanda Finance Corporation Ltd v Peat Marwick Hungerfords* (1997) 188 CLR 241 at 266 per Toohey and Gaudron JJ, at 284–285 per McHugh J, at 304 per Gummow J; *Perre v Apand* at [118] per McHugh J.

certification.[41] The fact that the financier could have made its own inquiries meant it was not vulnerable, in the sense of being unable to protect itself from the consequences of the auditor's want of due care.

Assumption of responsibility

(c) Whether there was an assumption of responsibility for the provision of information about the complex financial product.[42]

Commercial dealings

(d) The courts prefer to refrain from interference in ordinary commercial behaviour. The courts are concerned with whether the imposition of a duty of care in a competitive commercial environment would be inconsistent with community standards in relation to what is ordinarily legitimate in the pursuit of personal advantage.[43] If a person is legitimately protecting or pursuing his or her social or business interests, the common law will not require that person to be concerned with the effect of their conduct on the economic interests of others, even when the person knows that their actions will cause loss to a specific individual.[44]

Breach of fiduciary obligations

52. Whether a fiduciary relationship exists between a bank and a sophisticated investor will depend on all the circumstances of the relationship including the terms of any contract. As with the tortious duty of care, it will require facts that take it outside of the usual relationship that banks and investors in complex products and clients are in an arm's length relationship looking out for their own interests. It would also require extending the duty beyond those categories recognised by the law that create such a duty, such as lawyer-client, trustee and beneficiary, agent and principal and partners.

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[41] (1997) 188 CLR 241 at 266.

[42] *Esanda Finance Corporation Ltd v Peat Marwick Hungerfords* (1997) 188 CLR 241 at 255; *Woolcock Street Investments Pty Ltd v CDG Pty Ltd* (2004) 216 CLR 515 at [24].

[43] *Perre v Apand* at [33] per Gaudron J, at [395] per Callinan J.

[44] *Hill v Van Erp* (1997) 188 CLR 159 at 184 per Dawson J, at 211 per McHugh J; *Perre v Apand* at [115] per McHugh J, at [419]–[421] per Callinan J.

The nature of a fiduciary relationship

53. A fiduciary has the following duties:

(a) to avoid a position of conflict without informed consent;

(b) not to make a profit without informed consent.

54. The critical feature of a fiduciary relationship is that the fiduciary agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense.[45] All of the facts and circumstances must be carefully examined to see whether the relationship is, in substance, fiduciary.[46]

55. Importantly, it is open to the parties to a contract to exclude or modify the operation of fiduciary duties.[47] Where the fiduciary duties have been excluded the contract as a whole in the light of the surrounding circumstances known to the parties and the purpose and object of the transaction must be considered.[48] Additionally, the provisions of a contract or related documentation relevant to the commercial relationship may not evince an intention on the part of the bank and investor to create a fiduciary relationship, especially where the circumstances are such that each party is to have regard to its own interests in an arms-length transaction and the investor has made warranties and representations that it is sophisticated and has made its own enquiries about the risks of a financial product.

56. In *Berndale Securities Ltd v How Trading Pty Ltd* [2010] VSC 216, How Trading bought and sold options and Berndale provided third party clearing services to How Trading under a "Derivatives Client Agreement" in relation to trades executed on the Australian Clearing House Pty Ltd. Under clause 6.4 of this Agreement, if in breach of the Agreement How Trading failed to meet any margin calls, Berndale had the power to exercise the default powers

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[45] *Hospital Products Limited v United States Surgical Corporation* (1984) 156 CLR 41 at 96 per Mason J.

[46] *Hospital Products* (1984) 156 CLR 41 at 71–72 per Gibbs CJ; *News Ltd v Aust Rugby Football League Ltd* (1996) 64 FCR 410 at 541 per Lockhart, von Doussa and Sackville JJ; *ASIC v Citigroup Global Markets Australia Pty Ltd* (2007) 62 ACSR 427 at [272]-[273].

[47] *Chan v Zacharia* (1984) 154 CLR 178 at 196; *News Ltd v Aust Rugby Football League Ltd* (1996) 64 FCR 410 at 539; *ASIC v Citigroup Global Markets Australia Pty Ltd* (2007) 62 ACSR 427 at [278]-[279] per Jacobson J.

[48] *ASIC v Citigroup Global Markets Australia Pty Ltd* (2007) 62 ACSR 427 at [281] per Jacobson J.

under that clause to deal with How Trading's portfolio by way of closing out one or more Derivatives Contracts to reduce Berndale's own exposure.

57. One of the issues was whether Berndale owed a fiduciary duty to How Trading. The contractual default powers given to Berndale were intended to permit it to protect its own interests. The exercise of the default powers had the consequence that an “adversary relationship” arose. It is the antithesis of a fiduciary relationship."[49]

58. While Berndale owed a duty of good faith - to have regard to the interests of How Trading and to act honestly and reasonably in the exercise of its default powers under clause 6.4 - it had no obligation to protect or advance the interests of How Trading over its own.[50] "Actions taken by Berndale were not as agent for How Trading. The relationship had an adversarial quality."[51] Berndale was entitled to act to protect its own position consistently power under clause 6.4 of the "Derivatives Client Agreement".[52]

59. An investor may seek to rely upon fiduciary duties as the basis for asserting the bank's obligation to disclose all information which might reasonably be regarded as relevant to the product. However, a general duty of disclosure is inconsistent with the current position in Australian case law that the scope of a fiduciary obligation to act in another's interest is proscriptive and not prescriptive.

60. In *Eric Preston Pty Ltd v Euroz Securities Limited* [2010] FCA 97[53], the client pleaded that the relationship between it and the stockbroker-financial adviser was fiduciary and contended that the alleged fiduciary relationship:

> "imported a duty to act diligently in the client's interests, to fully disclose all relevant matters and to exercise a reasonable degree of care, skill and diligence."[54]

The client asserted that the stockbroker-financial adviser had breach its fiduciary duties by:

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[49] *Berndale Securities Ltd v How Trading Pty Ltd* [2010] VSC 216 at [416] per Judd J.

[50] *Berndale Securities Ltd v How Trading Pty Ltd* [2010] VSC 216 at [36], [412] per Judd J.

[51] *Berndale Securities Ltd v How Trading Pty Ltd* [2010] VSC 216 at [36], [412] per Judd J.

[52] *Berndale Securities Ltd v How Trading Pty Ltd* [2010] VSC 216 at [36], [412] per Judd J.

[53] This was affirmed on appeal in *Eric Preston Pty Ltd v Euroz Securities Limited* [2011] FCAFC 11.

[54] *Eric Preston Pty Ltd v Euroz Securities Limited* [2010] FCA 97 at [423].

(a) "failing to act diligently in determining the nature and risks of the [Opes Prime margin loan] facility, and to advise [the client]"; and

(b) "failing to diligently investigate and assess the risks of the [Opes Prime margin loan] facility".[55]

61. The client had relied upon observations made by Brennan J in *Daly v Sydney Stock Exchange Ltd* (1986) 160 CLR 371 at 385:

> "Whenever a stockbroker or other person who holds himself out as having expertise in advising on investments is approached for advice on investments and undertakes to give it, <u>in giving that advice the advisor stands in a fiduciary relationship to the person whom he advises</u>.
>
> …
>
> The duty of an investment advisor who is approached by a client for advice and undertakes to give it, and who proposes to offer the client an investment in which the advisor has a financial interest, is a heavy one. <u>His duty is to furnish the client with all the relevant knowledge which the advisor possesses</u>, concealing nothing that might reasonably be regarded as relevant to the making of the investment decision including the identity of the buyer or seller of the investment when that identity is relevant, <u>to give the best advice</u> which the advisor could give if he did not have but a third party did have financial interest in the investment to be offered, <u>to reveal fully the advisor's financial interest, and to obtain for the client the best terms which the client would obtain from a third party if the advisor were to exercise due diligence on behalf of his client in such a transaction</u>."

62. However, in *Breen v Williams* (1996) 186 CLR 71, Gaudron and McHugh JJ observed at 113:

> "In this country, fiduciary obligations arise because a person has come under an obligation to act in another's interests. As a result, equity imposes on the fiduciary proscriptive obligations — not to obtain any unauthorised benefit from the relationship and not to be in a position of conflict. If these obligations are breached, the fiduciary must account for any profits and make good any losses arising from the breach. But the law of this country does not otherwise impose positive legal

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[55] *Eric Preston Pty Ltd v Euroz Securities Limited* [2010] FCA 97 at [423].

> duties on the fiduciary to act in the interests of the person to whom the duty is owed."[56]

63. These judicial observations were reconciled by Austin J in *Aequitas v Sparad No 100 Ltd (formerly Australian European Finance Corp Ltd)* (2001) 19 ACLC 1006. His Honour was of the view that such a claim was based on a misconception of the scope of fiduciary duties under modern Australian law and concluded, based on *Breen v Williams*, that the only obligations imposed on a defendant are obligations not to obtain an unauthorised benefit from the relationship and not to be in a position of conflict (without fully informed consent). His Honour said:

> "... most of the observations of Brennan J do not relate to the fiduciary character of the advisor's position.
>
> In my opinion, in light of the reasoning in *Breen v Williams*, Brennan J's dictum should be taken to refer, for the most part, to the contractual aspects of the advisor-client relationship. The duty to provide "best advice" and to disclose knowledge and information arise out of the advisor's "undertaking", and are therefore implied terms of the contractual retainer."[57]

64. Based on this analysis, there is no wider duty of disclosure unless it is imposed by contract. In the absence of any obligation by the bank to provide advice, there will be little scope to argue that a fiduciary duty will be imposed on the bank in selling complex financial products.

Misleading/deceptive conduct

65. Many claims in this area involve allegations of misleading and deceptive conduct in the marketing and selling of the product. Each case will depend upon on their particular facts.

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[56] This has been cited with approval by McHugh, Gummow, Hayne, Callinan JJ in *Pilmer v Duke Group Ltd (in liq)* (2001) 207 CLR 165 at [74].

[57] *Aequitas v Sparad No 100 Ltd (formerly Australian European Finance Corp Ltd)* (2001) 19 ACLC 1006 at [286]-[287].

66. A number of Australian statutes, such as section 1041H of the Corporations Act) and section 12DA of the ASIC Act provide broad ranging causes of action based on misleading and deceptive conduct. It is not possible to contract out of these provisions.[58]

67. Section 1041H(1) provides that "a person must not, in this jurisdiction, engage in conduct, in relation to a financial product or a financial service, that is misleading or deceptive or is likely to mislead or deceive."

68. Section 12DA of the ASIC Act [59] is in similar terms but only relates to "financial services", although defined so as to have a different scope to the definition in the Corporations Act Part 7.1 Division 4.[60]

69. Section 1041E applies to a narrower range of conduct than that to which s 1041H applies in that it to a statement or to disseminating information while s 1041H applies to "*conduct*". Section 1041E applies to a statement or dissemination of information wherever occurring while s 1041H applies to conduct in Australia.

70. While misleading or deceptive conduct often involves a representation, a representation is not a necessary component of the cause of action.[61] Mere wonderment or confusion is not misleading or deceptive, but may be considered so if there is evidence that the conduct was carried out with the intention of cheating, ensnaring or misleading.[62] It is sufficient that the conduct leads or is likely to lead to error.[63]

71. In determining whether conduct or representations are misleading to a class of persons, the High Court has said that it is necessary to isolate a representative member of the class of

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[58] See *Prosperity Group International Pty Ltd v Queensland Communication Co Pty Ltd (No 3)* [2011] FCA 1122 at [69] (in respect of section 52 of the former Trade Practices Act) and *Campbell v Backoffice Investments Pty Ltd* (2009) 238 CLR 304 at [130].

[59] Section 12DA of the ASIC Act (Misleading or deceptive conduct) provides that a person must not, in trade or commerce, engage in conduct in relation to financial services that is misleading or deceptive or is likely to mislead or deceive.

[60] ASIC Act s 12BAB.

[61] *Miller & Associates Insurance Broking Pty Limited v BMW Australia Finance Limited* (2010) 241 CLR 357 at [15]; *Butcher v Lachlan Elder Realty Pty Limited* (2004) 218 CLR 592 at [32], [108], [179]; *Campbell v Backoffice Investments Pty Ltd* (2009) 238 CLR 304 at [25], [102].

[62] *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191; *Murray Goulburn Co-op Co Ltd v New South Wales Dairy Corp* (1990) ATPR (Digest) 46-058.

[63] *Miller & Associates Insurance Broking Pty Limited v BMW Australia Finance Limited* (2010) 241 CLR 357 at [15].

persons to whom the conduct is directed with a view to ascertaining the likely understanding of an ordinary or reasonable member of the class and to disregard assumptions by persons which are extreme or fanciful.[64] The initial question which must be determined is whether the misconceptions, or deceptions alleged to arise or to be likely to arise, are properly to be attributed to the ordinary or reasonable members of the classes of prospective purchasers."[65]

Reliance and Causation

72. The critical issue concerns reliance and the extent to which sophisticated clients have in relied upon any misleading representations and whether that reliance caused the loss.

73. The statutory action is designed to compensate those who have suffered loss or damage "by" the misleading conduct. In provisions like s 1041I of the Corporations Act and s 12GF of the ASIC Act which confer the right to an action for damages, the only express guidance given as to the measure of those damages is to be found in the concept of causation in the word "by". In *Henville v Walker*, in respect of s 82 of the former Trade Practices Act, Gleeson CJ said:

> "The task is to select a measure of damages which conforms to the remedial purpose of the statute and to the justice and equity of the case. The purpose of the statute, so far as presently relevant, is to establish a standard of behaviour in business by proscribing misleading and deceptive conduct, whether or not the misleading or deception is deliberate, and by providing a remedy in damages. The principles of common law, relevant to assessing damages in contract or tort, are not directly in point. But they may provide useful guidance, for the reason that they have had to respond to problems of the same nature as the problems which arise in the application of the Act. They are not controlling, but they represent an accumulation of valuable insight and experience which may well be useful in applying the Act."[66]

74. The Federal Court has held that damages for misleading or deceptive conduct involving a misrepresentation cannot be recovered without reliance.[67] For the purposes of establishing the

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[64] *ASIC v National Exchange* (2005) 56 ACSR 131 at [23] per Tamberlin, Finn, Conti JJ.

[65] *Campomar Sociedad Limitada v Nike International Ltd* (2000) 202 CLR 45 at [105].

[66] *Henville v Walker* (2001) 206 CLR 459 at [18].

[67] *De Bortoli Wines Pty Ltd v HIH Insurance Ltd (in liq)* [2012] FCAFC 28 at [59]-[61]; *Manday Investments Pty Ltd v Commonwealth Bank of Australia (No 3)* [2012] FCA 751 at [28].

causal link between misleading or deceptive conduct and loss, "reliance" is a mechanism, not the only one, by which causation may be established in relation to loss said to have flowed from misleading and deceptive conduct. Reliance has also been described as "a link in the chain of causation" from breach to compensable loss.[68] For example, in *Wardley Australia Ltd v Western Australia*, the High Court commented that where the misleading conduct consists of misrepresentation "as at common law, acts done by the representee in reliance on the misrepresentation [constitute] a sufficient connexion to satisfy the concept of causation".[69] However, in cases where the misleading conduct involves a failure to speak or advise, reliance is less useful.

75. Whether relief is available to a sophisticated investor depends on whether it has suffered loss or damage "by" the conduct of the bank. The onus is on the plaintiff to prove loss and to establish the extent of the loss suffered. The conduct complained of does not have to be the only cause. It is sufficient if it plays a part in the plaintiff’s loss or damage, even if only a minor part.[70]

76. The determination of a causal link between the impugned conduct and the loss or damage may require account to be taken of subjective factors relating to a particular person's reaction to conduct found to be misleading or deceptive in the sense that it would have a tendency to lead a person into error but may be disbelieved by the particular addressee in question.[71] There may be cases where a party's erroneous understanding of a transaction is wholly the result of its own misconceptions.[72] It is also well-established that the circumstance that a consumer, who is in fact induced to rely upon a statement which is objectively misleading, could have avoided the loss consequent upon that reliance by the exercise of reasonable care does not mean that the consumer did not act in reliance upon it so as to be entitled to recover damages by way of compensation for that loss.[73]

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[68] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332 at 356-357.

[69] *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514 at 525.

[70] *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* (2002) 210 CLR 109 at 128; *Salvatore Coco v Westpac Banking Corporation* [2012] NSWSC 565 at [88] per Hammerschlag J.

[71] *Campbell v Backoffice Investments Pty Ltd* (2009) 238 CLR 304 at [28].

[72] *Delmenico v Brannelly* [2008] QCA 74 at [34].

[73] *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* (2002) 210 CLR 109.

77. It must also be accepted that a statement may be seen in its context to be no more than the passing on, without adoption or endorsement, of a statement made by another and that a disclaimer of responsibility for the accuracy of a statement may serve to qualify the character of the statement which would otherwise be misleading, so that it can be regarded as innocuous.[74]

78. In *Campbell v Backoffice Investments Pty Ltd*, French CJ said:

> "A person accused of engaging in misleading or deceptive conduct may claim that its effects were negated by a contemporaneous disclaimer by that person, or a subsequent disclaimer of reliance by the person allegedly affected by the conduct. The contemporaneous disclaimer by the person engaging in the impugned conduct is likely to go to the characterisation of the conduct. A subsequent declaration of non-reliance by a person said to have been affected by the conduct is more likely to be relevant to the question of causation."[75]

An analysis of the effect of misleading or deceptive conduct cannot be divorced from disclaimers about that conduct or surrounding facts and circumstances which might quality its character.[76]

Concluding remarks

79. In determining the extent of a bank's liability for the sale of complex financial products, the starting point is to properly characterise the relationship between the bank and the investor. That will form the basis for determining what the bank's duties are whether they be contractual, tortious or statutory. Depending on the nature of the legal relationship, those duties may include the bank's obligations to warn investors against investing in those products, taking it out of the norm of the ordinary arm's length buyer-seller relationship.

80. It is apparent from recent US and UK cases that the sophistication of the investor is a significant factor in determining the extent of any exposure to liability a bank may have. The courts are likely to give considerable weight to the investor's experience in purchase complex products, be they structured derivatives, swap products or CDOs, especially with a view to

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[74] *Delmenico v Brannelly* [2008] QCA 74 at [35].

[75] *Campbell v Backoffice Investments Pty Ltd* (2009) 238 CLR 304 at [29].

[76] *Campbell v Backoffice Investments Pty Ltd* (2009) 238 CLR 304 at [30].

discerning whether the investor is capable of distinguishing between statements that the investor is entitled to rely upon and be influenced by and those which cannot be so characterised.

81. The fact that complex financial products are involved is unlikely to distract a court from enforcing the principle of freedom of contract especially where large commercial parties of comparable bargaining power "are usually regarded as the best judges of their own interests".[77] As was said in *Titan Steel Wheels Ltd v The Royal Bank of Scotland PLC*:

> "[W]here, as here, the parties have purported to allocate by contract their respective roles and the risks involved in their relationship this will in the normal run preclude any wider obligation arising from a common law duty of care."[78]

[77] *Raiffeisen Zentralbank Osterreich AG v Royal Bank of Scotland PLC* [2010] EWHC 1392 at 321.

[78] *Titan Steel Wheels Ltd v The Royal Bank of Scotland PLC* [2010] EWHC 211 at [89].