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Misselling allegations dismissed as High Court holds the line.

In a further decision dealing with issues of alleged misselling of financial products – *Standard Chartered Bank v Ceylon Petroleum Corporation*[1] – Mr Justice Hamblen gave judgment for Standard Chartered Bank ("SCB") for recovery of US$161 million (plus interest and costs) from the Sri Lankan state owned oil company, Ceylon Petroleum Corporation ("CPC").

As well as rejecting CPC's counterclaims alleging breach of duty and negligence, Hamblen J dismissed defences based on alleged lack of capacity and authority as well as illegality under Sri Lankan law.

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Background

Between early 2007 and late 2008, CPC entered numerous English law-governed oil related derivative contracts with various banks, including Citibank, Deutsche Bank and local Sri Lankan banks, as well as SCB. The contracts were entered into against the backdrop of high and rising oil prices and a desire to hedge against the cost of physical oil imports.

The precise nature of the contracts varied but generally involved monthly payments being made by the bank to CPC if the oil price was above an agreed strike price and from CPC to the bank if the price fell below an agreed floor price.

Of the ten contracts entered into with SCB, two were in dispute. Both were described as "Target Redemption Forwards" – these were essentially a combination of put and call options, known as a "Zero Cost Collar", with some additional features:

- a cap on the amount that the bank had to pay if the oil price was above the strike price (known as a "Seagull");
- leverage such that the number of notional barrels of oil on the "downside" (ie. where CPC paid) was greater than that applicable on the "upside" (ie. where the bank paid); and

[1] [2011] EWHC 1785 (Comm)

- a "knock out" such that the contract terminated with no further obligations if and when the bank's total payments reached a specified amount.

The transactions were negotiated and signed by CPC's Chairman and Deputy Manager of Finance following general resolutions from the board of CPC. These had followed the recommendations of a Study Group which had been set up by the Central Bank of Sri Lanka to consider hedging and a letter sent on behalf of the Minister of Petroleum to CPC enclosing those recommendations.

Towards the end of 2008 the oil price dropped suddenly and dramatically, resulting in large sums being due from CPC to the various banks, including SCB.

The dispute

In resisting payment of the sums due to SCB, CPC complained that, far from being genuine hedges, all the transactions were in fact speculative and outside their capacity. CPC's expert pointed to numerous "indicators of hedging" including features of the transactions as well as the general strategy of the Chairman, which they portrayed as being more akin to trading for profit than genuine hedging. As such, CPC argued, the transactions were outside the company's objects and therefore void. In addition, they alleged that those signing the contracts had no actual or ostensible authority to do so, also rendering the contracts null and void.

CPC also alleged that they had been induced to enter the transactions by misrepresentations as to the transactions being true hedges for their physical exposure and that, on the facts, SCB was liable in damages for breach of a duty to advise.

CPC accepted that Hamblen J was bound by *Springwell Navigation Corporation -v- JP Morgan Chase Bank and others*[2] to find that the disclaimers and non reliance statements in the documentation gave rise to a contractual estoppel preventing CPC from relying on the alleged advisory duty, but sought to get round this by arguing that:

- the disclaimers only applied to the specific transaction in question and not more generally in relation to a duty to advise on overall strategy; and
- there existed a "reverse estoppel" – essentially that CPC and SCB were acting on a shared assumption that – notwithstanding the relevant contractual provisions – SCB would advise and guide CPC and CPC had entered the trades with SCB on that basis.

CPC also ran a defence based on alleged illegality. Following a Sri Lankan court order the Central Bank of Sri Lanka had purported to direct the banks not to give effect to the transactions. This somehow translated, it was argued,

[2] [2010] EWCA Civ 1221. A Linklaters note on this case is available here.

to the commission of a criminal offence by CPC if it effected payment. The court should not therefore enforce payment on the principle in *Ralli Brothers*.

The Court's decision

The judge found against CPC on all points. The judgment is largely based on its own facts which are considered with great care by Hamblen J and we do not discuss every issue. However some points of general application arise:

- The judge applied *Springwell* in distinguishing between the mere giving of advice and the existence of an advisory duty – the former is not in itself sufficient to establish the latter.
- While a bank may do various things above and beyond being a pure counterparty – such as using the experience of its international offices as a selling point; making presentations; supplying information on market prices; providing views on market movements and forecasts; and describing various products to its customers- such behaviour does not in itself equate to holding out as an advisor and undertaking a legal responsibility to advise. There is a clear line to be crossed before a bank is likely to assume such a duty.
- Even if a duty could have arisen on the facts, the various disclaimers and statements of non reliance in the contractual documentation – an ISDA Master Agreement, Term Sheets and Confirmations – were effective to negate the duty. Furthermore, the non reliance statements gave rise to a contractual estoppel preventing CPC from alleging a duty and the judge rejected CPC's arguments around this.
- Whilst no misrepresentations were found to have been made on the facts, nor any reliance on the representations complained of, Hamblen J would have found the Entire Agreement clause in Section 9(2) of the ISDA Master Agreement effective to estop a claim in misrepresentation and to have satisfied the test of reasonableness in section 3 Misrepresentation Act 1967.
- Whilst CPC's capacity was a matter of Sri Lankan law (on which expert evidence was given) it was accepted effectively to be the same as English law. Consideration was given in particular to whether the transactions in issue were "speculative" in nature rather than hedging. Hamblen J was not satisfied on the basis of the nature of the transactions and detailed consideration of the expert evidence that the transactions were speculation. He found that they were within CPC's objects. Whilst a public corporation, CPC was also a commercial trading operation involved in import and export of oil and the transactions were conducive or incidental to that business.
- *Hazell v Hammersmith LBC*[3] was not an analogous case and reliance on it was misplaced. It did not lay down general rules applicable to

[3] [1992] 2 AC 1

the characterisation of derivative contracts. It concerned a different context, different transactions and a different inquiry.

On the facts (based on Sri Lankan law) the direction of the Central Bank did not render payment of the transactions illegal in Sri Lanka. However the parties had specified “New York” as the place of payment in the ISDA documentation. The place where payment was made – not where the payment emanated from – was the relevant consideration.

Next steps

CPC is appealing against Hamblen J’s findings on capacity and hedging versus speculation. They are not proposing to appeal on the misselling or illegality parts of the claim.

Linklaters LLP acted for the Bank in this case. For a copy of the High Court judgment, click here.

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