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Marketing in Spain of financial instruments subject to English law: Judgment of the Supreme Court of 20 July 2017 (Roj[1]: STS 3027/2017)

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The Spanish Supreme Court has held the clause of submission to English law included in a financial instrument acquired by an expert investor to be invalid, finding that such clause did not meet the conditions necessary to conclude that the submission thereunder was expressly agreed or that it was clearly demonstrated by the terms of the contract between the issuer and the investor or the circumstances of the case.

1. The judgment

The Supreme Court has invalidated a clause of submission to English law included in a financial instrument classified as 'high risk' – specifically a structured note called '*Nota Estructurada Autocancelable 3 bancos europeos abril 2013*' – acquired by an expert investor, despite the fact that such submission appeared in both the Base Prospectus and the Final Terms, to which the purchase order signed by the claimant explicitly referred, and the summary of the Base Prospectus published in the Spanish Securities Market Authority's[2] website. Moreover, the documents containing the submission to English law were available to the investor and publicly accessible.

[1] *Repertorio Oficial de Jurisprudencia* or Spanish case law identifier.

[2] *Comisión Nacional del Mercado de Valores (CNMV).*

The issuer (Morgan Stanley) did not sell the structured note directly to the investor, but through one of its subsidiaries (although the claimant refers to it as a branch). That is why the issuer claimed that its connection with the investor was not contractual, but rather documentary, with the consequence that its rights and obligations vis-à-vis the investor stemmed from the financial instrument, which had been made subject to English law.

However, without going into a rebuttal of the documentary nature of the relationship, the Supreme Court considers that the conflict-of-laws rule applicable to the case is that of Article 3(1) of the Convention on the law applicable to contractual obligations (Rome Convention) - applicable by reason of the time at which the contract was concluded and equivalent to Article 3 of Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I) - according to which a contract shall be governed by the law chosen by the parties. In order to ensure the free exercise of the freedom of contract, this article requires that the choice "*be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case*".

According to the Court, "*it cannot be understood that a choice of English law was expressly made by the claimant when acquiring the Structured Note, nor that such a choice is clearly demonstrated by the terms of the contract entered into by the claimant or the circumstances in which it was made, on the basis that the documents containing the submission to English law were available on the website of the Luxembourg Stock Exchange or on the website of the Spanish Securities Market Authority*". The Court concludes that the pre-contractual information was insufficient because the choice of English law did not appear in the purchase order itself signed by the claimant and did not appear in the information documents provided to the claimant prior to the signing of the purchase order.

The Supreme Court adds that the fact that the issuer of the structured note was an English company is also not a circumstance that demonstrates for certain that the contract will be governed by English law when it was concluded in Spain and both the person who issued the purchase order and the person who received it were Spanish nationals.

This judgment is the first to address this issue in the aforementioned sense, and there is therefore no "case law" in this respect. In addition, the Court's decision is likely to be influenced by the fact that the marketer of the financial instrument was a subsidiary of the issuer and by the complex nature of the product sold. Nonetheless, the Court's decision merits some analysis.

2. Criticism from the perspective of Private International Law

In the case under consideration, two different relationships arise: one between the investor and the intermediary company, which is not the subject of this analysis, and the other between the investor and the issuer. With regard to the latter, two issues stand out:

(i) The characterisation of the relationship between the issuer of the financial instrument and the investor as a contractual one is, at the very least, questionable. If we consider it, which would probably be more accurate, as a documentary one, the governing law would be that of England, since the issuer's obligations cannot change depending on the place where the document of title is traded, but are determined solely by the terms and conditions attached to it. However, the Court overlooks this issue and conducts a contractual analysis of the dispute, the conformity of which with our Private International Law rules stirs many a doubt.

(ii) Even if the contractual characterisation of the case is presupposed, the application of the Rome Convention (currently Rome I Regulation) should lead to the conclusion of the validity of the clause of submission to English law in issuer-investor relations. As has been seen, Article 3(1) enshrines the freedom of contract of parties, who are free to choose the law that shall govern their contract. Here, only in the case of contracts with a weaker party (Articles 6-8), which include consumer contracts, the freedom of contract is subject to limits that are not provided for the rest.

This circumstance cannot be disregarded by putting forward a characterisation of the investor comparable to that of a consumer because, in addition to other considerations, the Rome Regulation itself excludes this possibility in recital 28, according to which "*It is important to ensure that rights and obligations which constitute a financial instrument are not covered by the general rule applicable to consumer contracts, as that could lead to different laws being applicable to each of the instruments issued, therefore changing their nature and preventing their fungible trading and offering. Likewise, whenever such instruments are issued or offered, the contractual relationship established between the issuer or the offeror and the consumer should not necessarily be subject to the mandatory application of the law of the country of habitual residence of the consumer, as there is a need to ensure uniformity in the terms and conditions of an issuance or an offer*".

On that basis, the issue should be redirected to Article 3 of the Rome Convention (and the Rome I Regulation) and to the interpretation of its requirement of acceptance of the choice of law to be made expressly or be clearly demonstrated. There is no case law of the Court of Justice of the European Union (CJEU) in this respect, but it would not be too farfetched to imagine that, if it were to arise, the CJEU would render an interpretation similar to that rendered when it had to pronounce itself on the Brussels Convention (and subsequently Articles 23 and 25, respectively, of the Brussels I and II Regulations) on the choice of forum clauses. These provisions regulate only the formal conditions for the inclusion of the clause, but it is the unanimous view that in doing so, its main function is to protect the consent of the parties.

In its interpretation, the CJEU takes the view that in contracts between sellers or suppliers, the inclusion of standard terms and conditions is valid if the contract contains an express

reference to them. Applying this reasoning to a case concerning an action to void a bond purchase contract (Case C-366/13), the CJEU stated that "*where a jurisdiction clause is included in a prospectus concerning the issue of bonds, the 'in writing' requirement laid down in Article 23(1)(a) of Regulation No 44/2001 is met only if the contract signed by the parties upon the issue of the bonds on the primary market expressly mentions the acceptance of that clause or contains an express reference to that prospectus*" and that "*a jurisdiction clause contained in a prospectus produced by the bond issuer concerning the issue of bonds may be relied on against a third party who acquired those bonds from a financial intermediary if it is established, which it is for the referring to verify, that (i) that clause is valid in the relationship between the issuer and the financial intermediary, (ii) the third party, by acquiring those bonds on the secondary market, succeeded to the financial intermediary's rights and obligations attached to those bonds under the applicable national law, and (iii) the third party had the opportunity to acquaint himself with the prospectus containing that clause*".

Even if these conditions are not met, it is still possible to affirm the validity of the clause if its insertion into the prospectus "*may be regarded as a form which accords with a usage in international trade or commerce*".

In view of the above, it is at least doubtful whether the Supreme Court is not going too far in its control of the choice of law clause. However, in view of the judgment, it may be advisable to take certain precautions when attempting to market financial instruments subject to foreign law in Spain.

3. Practical conclusions

In light of the conclusions reached by the Supreme Court, and without prejudice to the fact that it will be necessary to await further development of the case law in order to assess the issue with greater certainty, it may be advisable to (i) make for Spanish investors an express reference in the prospectus of the choice of law clause and, particularly, (ii) require intermediaries to expressly state in purchase orders that the instrument is subject to English law and that said same statement appears in the information documents provided to investors prior to signing an order.