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Voiding and termination of contract as remedies for a breach of duties to inform in the purchase of financial products

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In the far-reaching legislative and case law context of a breach of duties to inform in the purchase of financial instruments, courts sometimes disregard differences between the categories of voidance, reparation and termination. Other times, such as in the case at issue, courts seek to lay down a hierarchy of remedies, holding, in this instance and without basis, that a termination for breach is not an adequate remedy.

I refer to the Judgment of the Supreme Court of 13 September 2017. The client purchases from Bankinter preferred bonds from the Finnish bank Landbansky, the outcome of which is known by all. The client brings, in the main, an action to void and, in the alternative, for termination, for breach of pre-contractual duties to inform in accordance with Mifid rules. The action to void is held time-barred and this pronouncement is final and conclusive when appealed on the grounds of a breach of the rules governing the determination of disputes ("cassation"). The Supreme Court does not uphold the appeal with the unsubstantiated statement that the contract cannot be terminated, only voided, for a breach of pre-contractual duties to inform, even if in fact an obligation (not acting in good faith during negotiations – *culpa in contrahendo* – lies outside the concluded contract?); only breaches "on performance" would be repudiatory. Some previous case law supports this statement (Judgments of the Supreme Court of 19 November 2015 and 13 July 2016) and another seems to contradict it (Judgment of the Supreme Court of 9 September 2014).

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This reasoning cannot hold, unless an attempt is implicitly being made to introduce a principle of rationality in the legal system, according to which the limitation period of art. 1301 of the Civil Code (“CC”) cannot be avoided by the alternative use of another remedy with a different limitation period and the same circumstances.

But if this rationality is what is ought, the result is also unsuccessful. The judgment, of course, guarantees that the investor always has an action for damages for breach. However, let us bear in mind that such action results, in cases such as the present one, of a “loss of the investment”, in the claimant obtaining reparation of sorts structured as an “improper termination of contract”, because in fact the loss ends up matching the quantum of compensation that would have been obtained by means of the contractual termination. And both actions are subject to the same limitation period.

Once reduced to 5 years the general limitation period under the new art. 1964 CC, the judicial incentives to determine that a termination does not lie are likely to change. Especially because the courts have imposed such a generous *dies a quo* on reparation by voidance (art. 1301 CC) of the “erroneous” purchase of financial products, that *at the terminus* the periods for voidance/reparation/termination will converge in practice.

What is needed, therefore, is for the courts to set out a clear hierarchy of competing remedies, if only for the rationality and predictability of the system. It has done so successfully in other sectors, such as the virtual competition of trademark infringement actions with unfair competition actions. And the prevailing rank should correspond to the actions that allow partial and adjustable solutions, which makes it advisable to postpone actions to void. Finally, it is better to argue that bank XX materially breached duties to inform, causing in such a way losses, than to argue that the bank committed such “breaches” in such a way that it caused the client to give consent that it would not otherwise have given: this assertion would almost always be counterfactual. In this direction, the recent judgement of the Madrid *Audiencia Provincial* (Twenty-first Chamber) of 25 July 2017 (concerning the trading of Bankia shares on the secondary market) rejects the appeal to void the share sale and purchase contract, holding that the appropriate remedy is to be found under the prospectus liability, which may lead to the same material outcome but in a less rigid manner.

I reproduce the relevant text of the judgment under consideration:

On the basis of scholarly texts and case law, it is indubitable that the consequence of a finding of mistake (in this case, due to insufficient information to the client) must lead to contractual invalidity and not to termination. In addition to the judgments of the Court cited in the appeal (14 June 1988,20 June 1996,21 March 1986,22 December 1980,11 November 1996,24 September 1997), we have most recently stated this in Judgment no. 654/2015 of 19 November 1980: “There is no doubt that a claim based on a pleading of vitiated consent, pursuant to articles 1265 et seq. of the Civil Code, in accordance with the very wording of the first of the above-mentioned provisions and article 1301 of the same legal text, must be inferred

by means of a petition to void; and not by means of an action for termination of the contract for breach". And as for damages for breach, said Judgment no. 677/2016 of 16 November: "5. In judgments 754/2014 of 30 December, 397/2015 of 13 July and 398/2015 of 10 July, we already noted that it could not "be ruled out that a serious breach of those contractual duties and obligations to inform the client and of care and loyalty with regard to financial advice could constitute the legal basis for attachment of liability for damage suffered by the clients as a result of the practically complete loss of value of the preferred shares, although it is logically necessary to prove what the causal link or relationship consists of". And in the previous Judgment no. 244/2013, of 18 April 2003, we understood that the bank's serious breach of the information duties required of the professional operating in the securities market in his relationship with potential or current clients "constitutes the legal basis for attachment of liability for damage suffered by such clients as a result of the practically complete loss of value of the preferred shares of Lehman Brothers acquired." Although this judgment refers to liability for the behaviour of the financial services provider under a discretionary portfolio management contract, the legal doctrine on the consequences of a breach of the standard of care is essentially applicable with regard to the requirements imposed by art. 79 bis (6) of the Securities Market Act on those who provide a financial advisory service. Hence, in accordance with this case law, an action for damages could be brought on the basis of a breach of the duties inherent in the suitability test and the resulting information to be provided to the retail client, provided that such breach would have resulted in the damage for which compensation is sought. This damage is the loss of the investment as a result of the bankruptcy of the issuer of the preferred shares. In such a manner that a breach of the duties inherent in the requirement of the suitability test and clear, precise, impartial and prior information regarding the risks inherent in the product being offered may be given the consideration of legal basis of the damage suffered, since if it is not established that the claimant was a high-risk investor (or, at the very least, that he or she was committed to the acquisition of that product), the bank should have refrained from recommending its acquisition, and therefore, in so doing, and by not informing on the risks inherent in the product, it resulted in the claimant assuming the risk that entailed the loss of the investment. "6. The foregoing leads to having to give the defendant's breach of its duties to inform on the risks inherent in the product the consideration of legal basis for the damage suffered, since Bankinter's breach of the duties to inform imposed by the securities market rules resulted in the claimant assuming the risk that entailed the loss of the investment". 3. - That is to say [?], even if we consider that the investment services firm did not properly discharge its duties to inform and that this resulted in the claimants not being aware of the risks inherent in the product it was purchasing, a possible mistake because of insufficient information could lead to the voiding of the contract, in accordance with arts. 1265, 1266 and 1301 CC. However, what does not lie is an action for termination of the contract for breach, under the terms of art. 1124 CC, given that the breach, by its very nature, must relate to the performance of the contract, whereas here the defective advice would have affected the provision of consent. Breach of legislation on the duty to inform the client of the financial risk of acquiring preferred shares may cause a mistake in the provision of consent, or loss resulting from such a breach, but does not determine a repudiatory breach. Without prejudice to the fact that the lack of information may lead to an alteration in the process of forming the will

that entitles one of the parties to void the contract, the fact is that such an approach is not linked to the breach of an obligation in the framework of a contractual relationship for the provision of an investment service, but is connected with the pre-contractual stage of formation of the will prior to the conclusion of the contract, and affects the very validity of the contract itself, so that the breach of this duty cannot have any repudiatory effect on the contract, since repudiation operates at a later stage, when there is breach of a contractual obligation.

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