A NEW BREED OF CLAUSE

THE EFFECT OF CONTRACTUAL ESTOPPEL ON CLAIMS IN ENGLAND AND WALES MADE BY FIDUCIARY INVESTORS

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Making an investment may be fraught with legal complexities. This is especially the case when it comes to clauses which seek to protect the investment manager or the financial institution through which any investment is made. Investment managers, as well as banks and other financial institutions (collectively, financial institutions), naturally seek to protect themselves in the documentation that governs the relationship between them and the investor in the event that a claim is made.

In the wake of the global financial crisis, there have been a number of cases that have considered claims for losses suffered as a result of investments which, in the eyes of the investors, have gone wrong. Investors have sought to assert claims against the relevant entity and circumvent the protective clauses that have applied to the relationship.

Attention has focused, in particular, on a new breed of clause: the ‘contractual estoppel clause’. The English courts currently appear willing to give effect to such arguments, although the modern principle has yet to be reviewed by the Supreme Court.

We consider the application of such clauses below, potential defences, and what may prudently be done about them.

What is contractual estoppel?
The principle applies where the parties to a contract agree certain facts and matters should form the basis of their relationship. Its effect is that neither party can subsequently deny the existence of those facts and matters upon which they have agreed, so long as those facts and matters concern those aspects of their relationship to which the agreement was directed. In this instance, the terms of the contract will prevent a party from alleging a different state of affairs to that which is set out in the contract.

Unlike evidential estoppel, contractual estoppel can be invoked on the basis of a contractual statement in a contract and without the necessity for the party relying on it to establish detrimental reliance. Equally, it does not need to show that it would be inequitable to resile from the statement in the contract.

The principle of contractual estoppel is therefore commonly advanced by financial institutions as a defence to claims of mis-selling, negligent advice, innocent or negligent misrepresentation.

In Colchester Council v Smith,1 Ferris J summarised the principle of contractual estoppel as follows:
‘A convention of the parties which binds them to adhere to an assumed state of facts, may amount to an express contract, in which case each party contracts with the other to be estopped...
...there may be an estoppel whereby parties are precluded, as a matter of contract ...from setting

1. [1991] 1 Ch 448
up a version of the facts different from that which they have agreed to assume.’

The principle of contractual estoppel is not affected by whether the agreed state of affairs actually reflects the underlying factual position. This position was confirmed by the Court of Appeal in Springwell v JPMorgan, where the court held that the parties to a contract can agree that X is the case, even if both know that it is not so.

Where a court finds that a party has agreed a state of affairs in a contract, that party is said to be ‘estopped’ from making certain arguments or claiming that a different state of affairs exists. The word estoppel is a misnomer because there is no estoppel in the ordinary legal sense of the word (a representation coupled with reliance). The principle is more like a warranty in a contract, but the remedy is not damages as it would be for breach of an ordinary warranty; instead the court will simply not allow a party bound by the estoppel to argue in relation to the target area of the warranty that the facts were otherwise than as warranted.

**Forms of contractual estoppel**

Contractual estoppel clauses may take the form of a representation, warranty, undertaking or a combination of the foregoing. In Springwell v JPMorgan, the fact that some statements were ‘representations’ rather than ‘acknowledgements’ made no difference to the analysis that they gave rise to a contractual estoppel.

They may be distinguished from exclusion and limitation of liability clauses, which are also commonly used by financial institutions to limit or exclude their liability for loss or damage caused by an underperforming investment or breach of a contract.

Listed below are some examples of contractual provisions that could give rise to contractual estoppel. These clauses commonly appear in agreements (for example, investment management agreements or terms of business) between investors and financial institutions:

- **Non-reliance clause:** this would include language to the effect that the investor has made its own independent assessment of the investment and the risks involved, and has not relied on any representations, warranties or other communications from the financial institution. The effect of this clause is often that a party cannot assert that he has relied on what was said by the financial institution. Reliance is often a crucial ingredient of a cause of action, so that no claim may be made.

- **Risk disclosure statements:** the contract may contain a risk warning or statement that sets out the risks in investing in the financial instrument, and a statement by a party that it understands the risks. This is the case with many derivative products. By entering into the contract, the investor may be estopped from claiming that he did not understand the risks, and relied on what he was told.

- **No warranty:** this is a statement that no communication by the financial institution shall be deemed to be an assurance or warranty as to the expected results of a transaction.

- **No advice, etc:** a contract may contain language which provides that the financial institution has not advised the investor of the suitability or appropriateness of the investment and that the investor should seek its own professional advice with respect to the investment. The clause may state that the other party agrees that the financial institution is not acting as an advisor in relation to the transaction, and has given no advice in relation to it, or made any personal recommendation to enter into it. The effect of this clause can be that the investor may be estopped from claiming that the financial institution owed the duty of an advisor, or provided negligent advice in respect of an investment, or a personal recommendation for an unsuitable product.

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2. [2010] EWCA Civ 1221
3. [2010] EWCA Civ 1221
Sophisticated investor: a contract may include a statement to confirm that the investor is a sophisticated investor and therefore understands and appreciates the risk of the investment.

Entire agreement: these clauses may provide that the written contract contains all the terms, and no representations not incorporated have been made or relied upon in entering into the contract. These clauses present potent difficulties for investors. Additionally, the financial institution may supplement them by incorporating a limitation of liability clause, such as:

Limitation of liability: this will seek to exclude all liabilities under the agreement except those arising from negligence, wilful default, fraud or breach of the agreement by the financial institution. An example of such wording is as follows:

‘The Manager accepts responsibility for loss to the Customer to the extent that such loss is due to the negligence, wilful default, fraud or breach of Agreement of, or by, the Manager.’

The protection afforded by such clauses may be moderated by restrictions, for example:

‘The investment objectives and restrictions stated in Appendix X will not be breached as a result of any events or circumstances outside the reasonable control of the Manager, including changes in the price or value of assets brought about solely through movements in the market.’

‘The Manager shall not be liable for any indirect, special or consequential loss, any loss of profit or business opportunity, any economic loss or any loss of goodwill.’

Recent case law has shown the court’s readiness to give effect to contractual estoppel arguments and demonstrates that parties will generally be bound by statements and acknowledgements made in the contract that define the basis on which they are dealing.

The principle is controversial. Until relatively recently, it was considered that the court would not in general act on a promise by a party that facts were X if they were not, or had not been proved to be X unless the other party could establish an evidential estoppel with reliance (Lowe v Lombank [1960] 1 WLR 196). The Court of Appeal in Springwell (overleaf) rejected that view, and endorsed the general application of the contractual estoppel principle. It remains to be seen what view the Supreme Court takes of this development.

In the meantime, investors should closely scrutinise the terms of any contract to ensure that:

1. it accurately reflects the state of affairs between the parties, and
2. it allows sufficient recourse to the financial institution should matters turn against the investor.

Trustees as investors

Trustees, as fiduciary investors, do not have the same commercial considerations when it comes to entering into litigation as individuals and businesses. Trustees have to consider their duties and obligations to their beneficiaries before deciding whether to litigate or not. A 19th-century
case held that trustees should pursue any losses that their trust has suffered, so long as there are sufficient funds to pay for it. This case, while old, is still good law. However, there is a gloss on it. The principle requires a trustee to pursue a debt that is owed to the trust, provided that: (a) there are sufficient assets in the trust to cover the cost of the relevant claim, and (b) there is a reasonable prospect of success in pursuing the claim. The trustee should only pursue ‘good claims’ and not fruitless claims with no real prospect of success. The trustee should also consider whether a Beddoe order is appropriate before commencing any litigation.

Where a trustee has acted unreasonably in pursuing a claim, the trustee may face a claim from the beneficiary of the trust. In these circumstances, the trustee may lose its indemnity from the trust assets and could be personally liable for the cost of the claim. The Beddoe order will provide comfort that a claim is sanctioned by the court and that the trustee is protected from personal liability in respect of a claim. In any case, the trustee should not sit back when a debt is due to the trust, but has a duty to seek to recover the debt in accordance with the principles laid out in Brogden. Failure to take action to recover the debt could result in a breach of trust and may result in personal liability for the trustee.

**Case law**

There have been a number of recent cases that have considered the doctrine of contractual estoppel in the financial services sector. Many of these cases relate to the mis-selling of derivative products to investors. One example is as follows:

‘Parties to a contract may agree that a particular state of affairs is to be the basis upon which they are contracting, regardless of whether or not the state of affairs is true. A line of authority establishes that such an agreement may give rise to a contractual estoppel, precluding the assertion of facts inconsistent with those that have been agreed to form the basis of the contract.’

Illustrations of the application of the contractual estoppel principle appear in the cases following.

**Springwell Navigation Corporation v JPMorgan Europe Limited**

Springwell was a sophisticated investor who made claims against JPMorgan for misrepresentation and misstatement in relation to loan notes linked to bonds issued by Russia. Russia defaulted and Springwell lost large sums of money.

In the contractual documentation between the parties there was a clause which stated that Springwell had not relied on, and acknowledged that JPMorgan had not made, any representation or warranty in relation to the advisability of purchasing the investment. The court held that such a clause gave rise to a contractual estoppel which prevented Springwell from claiming a misrepresentation as to the advisability of buying the investment.

**Bank Leumi v Wachner**

Ms Wachner traded various foreign exchange options with Bank Leumi. Following the closing out of the options, a debt was owed by Ms Wachner to Bank Leumi. This debt was not disputed, however, Ms Wachner alleged that her losses resulted from misrepresentations and/or negligence and/or breach of duty on the part of Bank Leumi.

The judge rejected the allegations of misrepresentation, negligence and breach of statutory duty. The judge followed previous cases, such as *Peekay Intermark v Australia and New Zealand Banking Corporation* and *Springwell Navigation Corporation v JPMorgan Europe Limited*. Bank Leumi’s terms and conditions contained the following provisions:

‘You agree that you will rely on your own judgment for all trading decisions’ and

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4. Re Brogden; Billing v Brogden (1888) 38 Ch D 546


6. [2010] EWCA Civ 1221

7. [2011] EWHC 656

8. [2006] 2 Lloyd’s Rep 511
Furthermore, any trading recommendation, market or other information communicated to you is incidental to the provision of services by BLUK under these Terms and BLUK gives no representation, warranty or guarantee as to its accuracy or completeness.

The judge held that such provisions prevented Ms Wachner from asserting that she was induced by any advice given by Bank Leumi to enter into the transactions.

*Cassa di Risparmio della Repubblica di San Marino SpA v Barclays Bank Ltd*

CRSM made a claim for misrepresentation in relation to various structured investment products that Barclays sold to it. The claim predominantly related to an assertion by Barclays that the notes that were being purchased had a AAA rating and therefore a low risk of default.

The judge held that a contractual term in the sales contracts would have precluded any claim. In the contract CRSM warranted that it understood and accepted the terms, conditions and risk of purchasing the notes. The clause stated:

‘6. Assessment and Understanding. We are capable of assessing the merits of and understanding (on our own behalf or through independent professional advice), and understand and accept, the terms, conditions and risks of entering into this Letter and of purchasing the Notes. We are also capable of assuming and we assume, the financial and other risks of entering into this letter and purchasing the Notes.’

The judge held that this wording effectively prevented CRSM from arguing that it was misled as to the risks of the notes.

*Camerata Property Inc v Credit Suisse (Europe) Limited*

Camerata purchased a loan note issued by a Lehman Brothers entity through Credit Suisse. When Lehman Brothers became insolvent, Camerata lost a significant part of its investment. Camerata had sought advice from Credit Suisse regarding its investments and claimed that advice was negligent as but for the advice, Camerata would have sold the investment before Lehman Brothers became insolvent.

The judgment interestingly distinguishes between what is required to establish negligence and gross negligence, but also refers to the application of a contractual estoppel. There were representations made by Camerata that it had independently assessed the suitability of the notes and was a sophisticated investor. In relation to this, the court held at paragraph 184 of the judgment that these representations were only stated to be made for the purpose of Credit Suisse buying investments for Camerata and did not apply to cases where Credit Suisse advised Camerata which investments Camerata purchased:

‘Parties to a contract can agree upon an assumed basis for their contractual relationship even if it is known not to represent the true position: see *Springwell Navigation Corp v JPMorgan Chase Bank* (loc cit) at paragraph 143. Equally, as it seems to me, they can agree that one contracting party makes representations and gives warranties which are to provide an assumed basis upon which the other can act for some specific purpose, but limit the application of that assumption and stipulate that the representations should be relied upon only for the specified purpose.’

The judge therefore decided that contractual estoppel was not available as a defence to the claim. The judgment illustrates the close attention the court will pay to the precise wording relied on, and how the result may turn on fine differences of language.

*Standard Chartered Bank v Ceylon Petroleum Corporation*

CPC entered into various oil-related derivative contracts with Standard Chartered. The price of oil dropped suddenly in 2008, meaning that...
large sums became owed to Standard Chartered under the contracts. CPC alleged, among other things, that it had been induced to enter into the transactions by misrepresentations and therefore Standard Chartered was liable for damages for breach of a duty to advise.

There were disclaimers and statements of non-reliance in the contractual documentation (an ISDA Master Agreement, Term Sheets and Confirmations), which were effective to negate any duty to advise. The non-reliance statements effectively gave rise to a contractual estoppel preventing CPC from alleging a duty to advise.

The non-reliance provisions stated that CPC:

‘has made its own independent decisions to enter into that Transaction and as to whether that Transaction is appropriate or proper for it based upon its own judgment’, and

‘is capable of assessing the merits of and understanding (on its own behalf or through independent professional advice), and understands and accepts, the terms, conditions and risks of that Transaction’.

The judge dismissed CPC’s allegations of breach of a general duty to advise, or a breach in relation to specific advice given by Standard Chartered.

### Challenging estoppel arguments

Some potential defences for challenging estoppel are:

- **Fraud:** A financial institution cannot rely on non-reliance clauses to preclude liability for fraud. As a matter of English law, liability for fraud cannot be excluded or limited.

- **Statutory controls:** Often a contractual estoppel clause will not be subject to any control under the *Unfair Contract Terms Act 1977* or the *Misrepresentation Act 1967*. That is because the clause does not exclude liability for breach, but prevents liability arising in the first place, for example, because it prevents a representation from being relied on, or a duty to advise arising. However, there are cases where an estoppel clause has been treated as an exclusion clause, and therefore subject to the requirement that it be reasonable if it is to be effective. If, for example, the clause states that no representation was made, but in the context in which it was agreed, that effectively rewrites history (possibly where a party makes a representation verbally, but then provides in the small print of the later contract that no representation was made), then it may be treated as a clause that excludes liability for potential misrepresentation, and therefore be subject to s3 of the *Misrepresentation Act 1967*.

- **Misrepresentation as to effect of contract or a term:** It may also be possible to challenge a non-reliance clause if the investor can prove that the financial institution misrepresented the effect of a contract or the existence or effect of a term in the contract to the investor, and the investor, relying on that representation signed the document. In this instance, there is an argument that the term is not incorporated into the contract by the investor’s signature.

### Conclusion

Where there is a contractual estoppel term, it may be very difficult, if not impossible, in the current state of the law for a party to claim at a later date that an advisory duty was owed, or advice, representations or personal recommendations were given, or that he relied on such matters.

Trustees investing, therefore, need to give the most careful consideration to such clauses which are frequently overlooked in practice. Can they be negotiated out of the contract? If not, precisely how wide are they? Insofar as they prevent any claim arising from any misunderstanding as to the underlying investment, what, if any, steps can and should the trustees take to safeguard their position, possibly as against independent advisors?