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HONG HONG COURT OF APPEAL FINDS AGAINST BANK ON THE BASIS THAT THE BANK'S EXCLUSION OF LIABILITY CLAUSES WERE UNCONSCIONABLE AND UNREASONABLE

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Legal Briefings

The Hong Kong Court of Appeal (**CA**) has recently affirmed a decision of the Court of First Instance (**CFI**), in which a ruling was made in favour of the plaintiff investors in a mis-selling claim against a bank, albeit on different grounds to that of the CFI (click here for the full judgment and here for our e-bulletin on the CFI decision).

Overturning the CFI's ruling on contractual interpretation, the CA held that the exclusion clauses in the bank's services agreement did apply to the plaintiffs' non-discretionary accounts. The CA however went on to find that the exclusion clauses the bank sought to rely on to limit its liability were unconscionable under the *Unconscionable Contracts Ordinance* (**UCO**) and did not satisfy the requirement of reasonableness under the *Control of Exemption Clauses Ordinance* (**CECO**).

This is the first decision of its kind where the court considered unconscionability in a banking context.

BACKGROUND AND CFI DECISION

The underlying dispute was brought by a Mr and Mrs Chang (an elderly married couple) and Nextday International Limited (of which Mrs Chang was the sole director and shareholder). Having incurred substantial losses in their private banking accounts with the bank from late 2004 to late 2008, the plaintiffs made claims against the bank for negligent advice, misrepresentation and breach of contract.

Having found that the bank had contracted to provide advisory services to the plaintiffs in respect of their non-discretionary accounts, the CFI found that the exclusion clauses contained in the bank's services agreement did not apply to this category of accounts.

The CFI held in favour of the plaintiffs on the basis that the bank had breached its contractual duty of care to the plaintiffs in advising and recommending investment products which did not match the plaintiffs' investment objective.

THE CA'S DECISION

On appeal by the bank, the CA again held in favour of the plaintiffs, but on different grounds to that of the CFI.

Application of the exclusion clauses to the plaintiffs' non-discretionary accounts

On the facts and circumstances of the present case and also the terms of the bank's services agreement, the plaintiffs' accounts should have been considered as non-discretionary accounts in the normal sense and the bank's exclusion clauses should have been construed to apply to this category of accounts.

UCO

The UCO was applicable to the bank's exclusion clauses, given that private banking services, whilst only available to the wealthy, were services ordinarily provided for private use, consumption or benefit.

The CA applied the Australian approach of considering the applicable industry code as a relevant matter when assessing unconscionability, on the basis that the UCO was drafted with reference to Australian legislation.

The CA took the view that the then applicable 2003 version of *The Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission* (**Code**) was the relevant standard in this case, as this was a standard of fair and responsible dealings in the financial industry agreed upon by the stakeholders.

Whilst the CA accepted the Code as the embodiment of the business conscience to which it could make reference in assessing what is unconscionable in the context of the UCO, it also noted that, depending on the circumstances, not every breach of the Code would give rise to unconscionability under the UCO.

In coming to the conclusion that the exclusion clauses were unconscionable, the CA had regard to:

- the failure of the bank to comply with its regulatory duties which were in place to protect investors like the plaintiffs; and
- the bank's actions in depriving the plaintiffs of the opportunity to make informed decisions on the risk level of products they invested in.

The CA had no doubt that the features in the present case were so aberrant from the commercial norms that the reliance of the exclusion clauses in question to avoid liabilities on the part of the bank could properly be characterised as unconscionable.

The CA held that it was not reasonably necessary to give the exclusion clauses their full effect to protect the bank’s legitimate interest, as there was no reason why the bank should have any legitimate interest to avoid liabilities on the facts of the present case when all the bank needed to have done was either to:

- make it very clear to customers that they only acted as salesperson and the recommendations of their representatives might not be consistent with the customers’ objectives; or
- to take reasonable steps to make sure customers understand the risk level of the products they recommended.

CECO

The CECO was also applicable given that the relevant clauses functioned as exemption clauses.

The CA determined that, as a matter of substance, the exemption clauses in question were provisions which excluded or restricted the relevant obligation or duty of the bank and, as such, would not be effective to exclude or restrict liability for negligence unless they satisfied the requirement of reasonableness in the CECO.

Given the CA's conclusion on unconscionability of the exclusion clauses, it concluded that the bank failed to satisfy the CA that the clauses were fair and reasonable ones.

The CA therefore held that the bank could not rely on these exclusion clauses to escape liabilities to the plaintiffs.

COMMENT

This decision represents a significant turning point in the context of Hong Kong mis-selling cases. Many of those cases have found in favour of the bank, and in doing so have upheld the express terms of the contract signed or applying between the bank and customer – essentially approving the doctrine of contractual estoppel.

The CA in this case provides customers with a potential new argument in these types of cases, in that certain express terms of the contract may be unconscionable. If this decision stands, and it remains to be seen whether this case will be appealed to the Court of Final Appeal, then banks may find it more difficult to rely on their express contractual terms to exclude liability to customers going forward.

This is particularly apt in the context of recent regulatory changes implemented by the Securities and Futures Commission, which require the incorporation of a new mandatory clause on suitability into client agreements, with effect from June 2017. Where that clause applies, banks will not be able to rely on relevant contractual exclusions in any event.

For further details regarding the mis-selling cases in the recent years, please refer to our e-bulletins of 23 May 2013, 29 May 2015 and 27 June 2016.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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