

Execution-only relationship – transactions without mandate and calculation of damages

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Introduction

A recent Supreme Court decision concerned a case in which a relationship manager with a Swiss bank left said bank without the relevant bank's client being informed. The relationship manager continued to act on the client's behalf and gave investment orders to the bank, which the bank followed.

Important losses in the client portfolio resulted from these unauthorised orders. The bulk of the Supreme Court decision discussed how the relevant damages suffered by the client must be alleged, contested and determined.

Determination of damages under Swiss law

According to the Supreme Court, with regard to a bank's liability in relation to discretionary asset management and investment advisory mandates, clients may require from the bank indemnification of the amounts which the client would have gained or earned had the mandate been executed correctly. This requires a comparison between the client's actual portfolio as a result of the incorrect execution of the mandate and the hypothetical portfolio which would have resulted from a correct execution of the mandate.

The determination of such damage may be carried out using different methods: in particular, prejudice may be calculated by comparing a portfolio before the transactions made without a mandate (or powers) and after such transactions have been made; another method is the addition of the losses triggered by the operations made without a mandate.

Supreme Court decision

Facts

In July 2007 a foreign resident concluded an execution-only relationship with the Geneva branch of a Swiss bank.⁽¹⁾ The client and the bank agreed on a hold mail (*banque restante*) arrangement and enclosed a contestation clause (including a fiction of acceptance clause) by the client if no contestation was made within one month after the issuance of the statements of accounts.

From 2007 until mid-2009 the client was supported by a particular relationship manager. In mid-2009, the relationship manager left the bank. The bank did not notify the client that the relationship manager no longer worked for the bank nor enquired to know whether the former relationship manager was still empowered to instruct the bank on the client's account as an external asset manager. No power of attorney had been granted to the former relationship manager. However, the former relationship manager continued to give instructions to the bank on behalf of the client as an external asset manager through his asset management company. All of these operations were recorded by the bank and the corresponding account statements were held at the disposal of the client as hold mail.

Only in February 2010 did the former relationship manager inform the client that he had left the bank. Four days later the client reviewed his hold mail at the bank and discovered that numerous transactions had been carried on without any mandate granted by him to his former relationship manager.

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As a consequence, the client sued before the Geneva courts requiring the bank to pay \$1.7 million plus interest as damages. In short, after a first Supreme Court decision, the Geneva Court of Appeals considered that the bank had failed to obtain a power of attorney from the former relationship manager or question his ability to instruct the bank on the client's behalf. Even within an execution-only relationship, the bank should have questioned the client to confirm that the former relationship manager still had powers or at least have notified the client that the relationship manager was no longer with the bank.

The bank had committed gross negligence by accepting these orders and thus engaged its liability. The hold mail and fiction of acceptance clauses could not be applied in the case at hand as they would lead to an unjust result. The Geneva Court of Appeals considered that the client had sufficiently established his damage. In this respect, the relevant transactions had caused a loss of \$842,568.65, of which gains on fiduciary investment had been deducted, leading to a total prejudice of \$841,465.44 plus interest.

The bank appealed the Geneva Court of Appeals' decision before the Supreme Court.

Decision

The topical considerations in this Supreme Court decision concern the allegation and calculation of the damages that the client suffered. As mentioned above, where transactions are executed by banks without a mandate, clients may ask for the amount that would have resulted from the correct execution of the mandate;⁽²⁾ the damages may be determined by comparing a client's portfolio before and after the operations executed without a mandate or by adding all losses triggered by such operations.

The client required the defendant bank to pay the amount corresponding to the difference of the assets on his account between June 2009 and September 2010. In its response, the bank did not contest the method of calculation of the client's damages or the relevant dates. As the bank did not contest the alleged damages, they were deemed to have been accepted by the bank and did not need to be proven by the client.⁽³⁾ As a result, the client did not need to assert another method to determine the prejudice or assert the facts to be evidenced, contrary to the bank's allegations.

The Supreme Court noted that the Geneva Court of Appeals had used another method of determination of the damages than that asserted by the client and not contested by the bank. Indeed, the Geneva Court of Appeals had added all losses suffered (minus a realised gain) and decided that the relevant period was between 1 July 2009 and 23 February 2010. As a result, the damages determined by the Geneva Court of Appeals was smaller than those alleged by the client. The bank did not establish that the damage calculation made by the Geneva Court of Appeals had been arbitrary. The client had chosen the calculation method of the difference between its assets and the relevant dates and the bank had failed to oppose these two points; as a result, this method of calculation was deemed accepted by the bank. Further, as the damages determined by the Geneva Court of Appeals were smaller than the damages alleged by the client, the bank had no interest in the Geneva Court of Appeals using another method of calculation. Accordingly, the damages as determined by the Geneva Court of Appeals was to be confirmed.

Comment

This Supreme Court decision sheds an interesting light on how procedural legal dispositions may affect the determination of material rights. Indeed, as there are various methods to determine damages resulting from the execution of orders without a mandate, it was at the disposal of the claimant to choose whichever method was most favourable to him, even though the Geneva Court of Appeals decided to use another method. As per Swiss federal procedural law, the requirements to appeal a decision before the Supreme Court and notably to criticise questions of fact are strictly limited. Accordingly, should the bank have wished to contest how the client alleged or calculated the damages, it should have done so in the correct timeframe and procedural forms. Absent such contestation, the bank was barred before the Supreme Court and the method chosen by the client was deemed accepted.

FinSA

On 1 January 2020 the new Financial Services Act (FinSA) entered into force. The scope of the conduct obligations under FinSA vary in intensity depending on the client's classification under a newly introduced client segmentation⁽⁴⁾ (ie, retail, professional and institutional clients). Accordingly, the conduct obligations do not apply to dealings with institutional clients, and professional clients have the option of waiving compliance by the financial service provider with the conduct obligations.⁽⁵⁾

The main obligations under the conduct rules are as follows:

- the provision of information;⁽⁶⁾

- transparency and care;(7)
- documentation;(8)
- accountability;(9) and
- the obligation to carry out an appropriateness and suitability test.(10)

From a supervisory perspective, FinSA now determines the conduct obligations, which were previously stated in separate statutory regulations for individual industries or were defined in industry standards. It is unclear if FinSA is exhaustive or if self-regulations like the Swiss Bankers Association guidelines will still be maintained to the extent that they impose stricter regulations. There is a transitional period of two years (ie, until 31 December 2021), to implement the duties of conduct under FinSA.

While FinSA is financial market law (public law) that does not abolish or change the content of the applicable contract law between a financial institution and a client, it can influence the interpretation of such contract law and more particularly law of agency contracts. In other words, FinSA and agency contract law will coexist in parallel and a financial service provider will have to comply with both, in particular, the duty of care and the duty of loyalty applicable under general agency law. Given the slightly more stringent and more detailed approach under FINSA, it can be expected that banks and securities firms are likely to be held against a stricter standard by clients based on their contractual relationship (ie, agency contract law).

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Endnotes

(1) Supreme Court Decision 4A 126/2019 of 17 February 2020.

(2) For example, Daniel Guggenheim, Anath Guggenheim. *Les contrats de la pratique bancaire suisse*, Bern 2014, p 65ff

(3) By application of Article 150 Paragraph 1 of the Federal Procedural Code.

(4) Article 4 of FinSA.

(5) Article 20 of FinSA.

(6) Article 8 f of FinSA.

(7) Article 17 *et seqq* of FinSA.

(8) Article 15 of FinSA.

(9) Article 16 of FinSA.

(10) Article 10 *et seqq* of FinSA.

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