3VB'S FINANCE COLUMN: A REASONABLE BASIS

Jonathan Nash QC, of 3 Verulam Buildings, considers the courts treatment of basis clauses in the wake of *First Tower Trustees Ltd v CDS (Superstores International) Ltd [2018] EWCA Civ 1396* and asks if non-advisory or no warranty as to information clauses, like non-representation clauses, are also subject to the reasonableness test.

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STATUTE GOVERNS WHETHER A BASIS CLAUSE LETS YOU CONTRACT OUT OF OBLIGATIONS

The law relating to exclusion clauses, so-called basis clauses, and the *Unfair Contract Terms Act 1977* has got itself into a conceptual tangle in recent years. The decision of the Court of Appeal in *First Tower Trustees Ltd v CDS (Superstores International) Limited [2018] EWCA Civ 1396* brings some welcome clarity for the benefit of draftsmen and litigators.

Basis clauses are widely used in documents to define the scope of responsibility for issuers, arrangers and underwriters of bonds, structured instruments, and credit facilities of all kinds.

In *First Tower* (a case concerning pre-contract inquiries in a conveyancing transaction), Lewison LJ reviewed all the recent authorities and clarified a distinction which had been lost sight of. Importantly, he pointed out that whether a clause falls within the purview of the *Unfair Contract Terms Act 1977* depends on the construction of the statute, rather than the construction of the clause or the intention of the parties. Thus the parties may agree that a contract is entered into without reliance on any pre-contractual representations, and this may indeed give rise to a contractual estoppel, but nonetheless such a clause operates by way of an exclusion clause since, in the absence of the clause, one or other party would be entitled to claim that a pre-contractual representation had been made and could (provided of course the other requirements of section 2(1) of the *Misrepresentation Act* were made out), claim damages for negligent misrepresentation. He pointed out that tortious liability for pre-contractual misrepresentation is part of the general law which the parties are free to contract out of, subject only to any statutory restriction, and section 3 of the *Misrepresentation Act* was such a restriction. It followed that whether a clause was drafted in the form of an exclusion clause, or as a no primary obligation clause giving rise to a contractual estoppel, it was subject to the control mechanism of reasonableness.

NO PRIMARY OBLIGATION V EXCLUSION CLAUSES

The key distinction in play here is that identified by Toulson J at first instance in *IFE v Goldman Sachs [2006] 1 Lloyd's Rep 264 (Toulson J.); [2007] 2 Lloyd's Rep. 449 (CA)* where he contrasted two different statements made by a car salesman:

- Exclusion clause. A representation that the mileage reading on a car's odometer is accurate, coupled with further statement that the representation cannot be relied upon, would not have the effect that the earlier representation did not exist, but rather that liability for it was excluded.

- No primary obligation clause. A statement that the odometer carried a particular reading but that the salesman had no idea whether or not it was correct would have the effect that he was making no representation about the accuracy of the reading.

He returned to the point some years later with another homely example of a no primary obligation style clause in *Impact Funding Solutions Ltd v Barrington Support Services Ltd [2016] UKSC 57*, where he referred to a decorator who agreed to paint all the external woodwork of a house apart from the garage doors. The proviso relating to the garage doors simply defined the scope of the task being undertaken: it was not an exclusion clause of the kind that required statutory control.

WHY DOES THIS DISTINCTION MATTER?

Prior to *First Tower* a view appeared to be developing that basis clauses drafted as no primary obligation clauses, because they removed certain obligations from the ambit of the contract, were not subject to UCTA reasonableness.

The decision of the Court of Appeal in *Peekay Intermark Ltd v Australia and New Zealand Banking Group [2006] 1 CLC 582* and then in the cause celebre of *Springwell Navigation Corp v JP Morgan Chase Bank [2010] 2 CLC 705* identified what was arguably a new kind of contractual estoppel: parties are free to agree the basis on which they are dealing, including in particular whether they have relied on any representations from the other side in entering into the contract, and they will be held to their bargain. If such clauses are taken to define the scope of the contract rather than to exclude liability, then absent fraud (which of course unravels all) a party might be able to enter into a contract with any manner of representation or non-disclosure without assuming any responsibility at all to his counterparty, and without any legal control mechanism to prevent unfairness or exploitation.

First Tower reached the conclusion that a non-reliance statement should be treated as exclusion clause and subject to the reasonableness test but at the same time cast no doubt on the decisions in Peekay or Springwell.

In *IFE* and *Springwell* the court considered the following basis clauses:

- The financial institution gave no warranty of completeness of information provided and had no obligation to update it.
- There was no advisory relationship between the parties.

In both cases the clauses were upheld because they did not exclude liability but rather prevented the obligation from arising at all. These cases appear to remain good law.

SO HOW CAN WE KNOW WHICH BASIS CLAUSES ARE SUBJECT TO A REASONABLENESS TEST?

Lewison LJ suggested in *First Tower* that the touchstone for deciding whether a clause was of the no primary obligation type rather than an exclusion clause was simply to ask what the position would be in the absence of the clause. This test has a beguiling simplicity, but may not cover all eventualities. It is therefore not possible to say categorically that all basis clauses are to be treated like exclusion clauses and subject to reasonableness.

In particular, the *First Tower* test does not address the field of implied representations, where the presence of the clause is an important factor in deciding what, if any, representations have been made.

A financial institution may offer a financial instrument or participation in a syndicate based on specific information, whether contained in a memorandum or data room to which potential investors are given access. The issuer or arranger will have to decide what information is made available, and may well itself be dependent on information obtained from others. Other parts of the institution may have potentially relevant knowledge from other, unconnected dealings. Can the institution protect itself from a later complaint that the information which was made available was incomplete? There seems no reason in principle why the institution should not contract on the basis that it is not warranting that the information which it is providing is complete; that it does not possess

other relevant information from unconnected dealings; and that it will not be updating the information before completion.

However, by the same token, can the institution stipulate that it is not by delivering the memorandum or giving access to the data room advising or recommending the investment? Depending upon the precise facts, this seems more debateable.

HOW SIGNIFICANT IS THIS DECISION FOR FINANCIAL INSTITUTIONS AND THEIR COUNTERPARTIES AND CLIENTS?

Many (but by no means all) of the most commonly used basis clauses will be subject a reasonableness test.

However, even if basis clauses are subject to a legal control of reasonableness, it seems likely that in many cases of complex financial transactions between sophisticated parties the test will be satisfied easily enough. Certainly, Lewison LJ in *First Towers* appears to have thought so.

The position will be different however where smaller investors are concerned. The courts have been much occupied in recent years with complaints from retail investors, SME's, and non-financial institutions, who have complained about being misled into investing in unsuitable financial products. basis clauses have been deployed to shut out the claims. It seems likely that some of these clauses will be tested for reasonableness as true exclusion clauses within the meaning of the *Misrepresentation Act 1967* and *UCTA 1977*; and for individuals (but not companies) the position under the *Consumer Rights Act 2015*, with its broad concepts of good faith and significant imbalance in the parties' rights and obligations, will also be engaged.

It is therefore entirely possible that the same clause may satisfy the reasonableness test in a contract with a sophisticated institutional investor and fail it in a contract with a SME counterparty.