No place for market practice: *CFH Clearing v. Merrill Lynch International*

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Introduction

The High Court has held that a bank was not obliged to reprice or cancel foreign exchange spot trades entered into at a time of severe market disruption in accordance with "market practice": *CFH Clearing Limited v. Merrill Lynch International* [2019] EWHC 963 (Comm). The court refused to find an express or implied term to that effect. It also found that the bank had not breached its best execution policy or assumed a duty in tort to ensure the trades were correctly priced.

Background

In January 2015, CFH Clearing (CFH) entered into FX transactions with Merrill Lynch International (MLI) whereby it bought Swiss francs and sold euros. The transactions were documented by an ISDA master agreement and electronic confirmations. They were executed shortly after the Swiss National Bank removed the currency floor applied to the Swiss franc against the euro (referred to as "depegging"), which led to severe fluctuations in the FX market. Later that day, other banks amended the pricing of trades executed with CFH to reflect the official interbank low.

CFH argued that, since the FX trades were entered into at a time of severe market disruption, MLI was obliged to make a retrospective adjustment to the price, or to cancel them, in accordance with its express or implied contractual obligations, and/or pursuant to a duty of care in tort, which it had failed to do.

MLI applied for summary judgment and/or to have the case struck out.

Express term as to market practice

CFH argued there was an express contractual term that the parties would act in accordance with market practice. It relied on clause 7 of the bank's standard terms and conditions:

> "All transactions are subject to all applicable laws, rules, regulations … and, where relevant, the market practice of any exchange, market … including the FSA Rules …'

The court considered that, on its proper construction, the clause did not impose a contractual obligation to act in accordance with market practice, but was instead intended to relieve a party of contractual obligations where it was unable to perform those obligations because of relevant market practice. For example, if an order could not be fulfilled because its size was not traded on the particular exchange, this provision would operate to relieve a party of its

contractual obligations.

In reaching its view on the meaning of the clause, the court did not accept that the words "subject to" had the effect of incorporating all applicable laws, rules and regulations into the contract. That would result in uncertainty as to the terms of the contract, which would be unworkable. It would also be contrary to another express provision elsewhere in the contract, which provided that the FSA Rules were not incorporated.

Further, the court concluded that the interpretation contended for by CFH appeared to be contrary to common business sense. CFH's case was that an express term that the parties would act in accordance with market practice imposed on MLI an obligation to reprice the trades to bring the pricing within the accepted market range or else to cancel the trades. The commercial difficulty with that interpretation was that (1) requiring the parties to act in accordance with relevant market practice was too nebulous and broad a concept; and (2) it put forward two entirely different obligations (to keep the trades, but on different terms, or to cancel them altogether), without apparent regard to the parties' wishes.

Implied term as to market practice

Alternatively, CFH argued that there was an implied term that the parties would act in accordance with market practice.

The court rejected CFH's argument on the basis that where the parties have entered into an ISDA agreement, which contains extensive and comprehensive provisions used widely in the market, a general implied term for the incorporation of relevant market practice could not be said to be either necessary for business efficacy or so obvious that it went without saying. As with the express term, the uncertainty arising from the alternative obligations contended for (reducing the price or cancelling the trade) also militated against an implied term.

Best execution

CFH also argued that MLI was in breach of its obligations under its best execution policy. This included a duty to produce a fair result and to take all necessary steps to obtain the best possible results for its client which, in this case, it was suggested, meant complying with market practice.

The court had some doubts as to whether MLI's best execution policy had been incorporated as a contractual term. However, even if it had been incorporated, the court rejected CFH's case on this issue. There had been no problem with the execution of the trades, which had been executed promptly and at the price prevailing in the market. In the court's view, there was no real prospect of establishing that the policy would extend to a requirement to retrospectively adjust the pricing of the trades or to cancel them where the price of the trades executed had been affected by market turbulence.

Duty of care

CFH also brought a claim in tort, alleging that MLI had assumed a duty to take reasonable care to ensure the trades were priced correctly and, where orders were wrongly priced due to market turbulence, to retrospectively reprice them.

It was unclear on what basis a duty would arise. CFH accepted that MLI was not a fiduciary, and this was borne out by MLI's standard terms of business and by the express representations made by the parties under the ISDA agreement. The court held that there was therefore no real prospect of establishing a duty of care on the basis of the

relationship between the two "arm's length" professional parties.

In any event, the court found that there had been no breach of any duty to ensure the trades were correctly priced, as alleged. The "mispricing" had been caused by market turbulence, and MLI had carried out the orders placed by CFH at the then current prices. In the circumstances, it was unclear how a claim that MLI had failed to ensure the transactions were priced correctly could be sustained. As the court noted, the real complaint arose from the fact that, MLI having executed the trades as instructed by CFH, CFH then sought to change or unwind the contract.

Comment

It is unsurprising that the court was unwilling to find that the bank should be required to act in accordance with a concept as potentially broad and uncertain as "market practice". In particular, the court was unlikely to consider it necessary to imply a general term incorporating relevant market practice where the parties were operating under the comprehensive and widely used provisions of an ISDA agreement. Banks will also be reassured that any best execution policies derived from the Conduct of Business rules are unlikely to impose an obligation on them to cancel a trade or reprice it where the price has been affected by market turbulence.

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