

Damage Claim of Bank Customers for Wrong Advice Given by Bank Agents

Paper for *The International Conference
Present Issues in the Legal Banking Field*
Timisoara 31. –Oct – 3. Nov. 07

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Vorweg - Avant Propos

The following paper is based on German law. This, however, already is and will be more and more influenced, if not superseded, by European Law. It is therefore to be expected that the solutions given by the German courts and particularly by the German Supreme Court, Bundesgerichtshof (= BGH) will not substantially differ from other European courts on the same or similar questions.

Differences will however remain the field of the systematic approach, see below, and procedural law, e.g. in the establishing and handling of legal presumptions (see below).

I. Ausgangspunkt - Point of Departure

A legal obligation for the bank to inform and advise her clients on potential risks of the intended transaction can arise under two headings:

- Contract and
- Statute Law or in the UK: Common - Law

a. Contract

A comprehensive legislation on the banking contract (Bankvertrag) is still missing in most countries. BGB, the German Civil Code, recently introduced some new chapters to this end, but concentrating on consumer issues, it still does not cover the whole subject. About the same is true with the French Civil Code.

There are specified contracts in the codes on certain bank services, such as loan or credit agreements (Darlehensvertrag), money transfer (Girovertrag), fiduciary agreements (Treuhandvertrag) etc. Some specified contracts, which as such do not pertain to bank services, nevertheless regulate certain transactions, e.g. mandate, sales contract and others.

Each banking transaction must therefore be analysed as to which contractual obligations may arise for the bank (and/or client) in a given case.

b. Law

Pertaining European law has been transformed into the national legislation of the member states. The most recent transformation of European banking law with a direct bearing to our today`s topic takes effect in Germany law today. The WertpapierhandelsG – law on money instruments – has been changed in order to comply with European law. § 31 and other paragraphs of this law provide for a more effective and thorough information of the bank client.

c. Caveat – Vorbehalt

It would be inappropriate to expand on systematic questions and distinctions which exist, notably in German law, between contractual and legal obligations. The following will concentrate on contractual obligations. These are as a matter of fact the decisive ones for adjudicating or denying damages claims against banks.

There are two main groups of cases, which have been brought to court against banks by clients claiming damages for wrong advice or deficient information.

II. Systematical Approach - Systematik des Unterlassungsdelikts

Under a comparative aspect it may be said that German law has developed a rather doctrine of the *Unterlassungsdelikt*, i.e. torts or breaches of contract which are committed not by positively doing something (e.g. throw a stone or say certain words), but by not doing such acts which should be done under the given circumstances. ¹

Therefore, systematically speaking, it should be kept in mind, that damage claims for wrong advice or false information are virtually never based on some positive act of the bank. As far as can be seen, claimants never contend that Bank did positively tell them incorrect things or even lied to them.

Claimants` contention is always that bank (acting through her agent, *Erfüllungsgehilfe*, § 278 BGB) did *not do* certain things, e.g. she did not inform them on things she knew with respect to the transaction; or if bank did not know she should have known certain things and then should have told them etc.

This is also the way how these cases are treated by our courts. Following the general system there are 5 steps to be considered:

1. Is there any legal (contract or law) obligation at al for bank B to *do*, to inform, give advice etc?
2. If “yes”: Did B have the respective information?
3. If “no”: Was B under an obligation to get this information?
4. If “yes” : Was it by negligence that B did not inform herself? This of course depends on the circumstances, e.g. was the respective information easily at hand or not, was it foreseeable that this information would be important for client C? etc.

¹ German law seems to have developed this to a much higher degree of perfection than e.g. French or English law, although, of course, also in these do know this concept.

5. Would client C have avoided his loss or damage, if he had duly been informed ?

III. House Purchase – Loan Agreements (*Verbundgeschäfte*)

Example: ²

Claimant C has bought an apartment from seller S, who is a developer. The apartment was not only heavily overpriced; S had also told C, that he could earn 19 DM/squaremeter, which was far above the market price. C and S met for dinner, at which occasion S presents to C the loan agreement, already signed by bank B, for the sum necessary to finance the transaction. C countersigns the contract. S and B have conducted similar transactions before. Now C realized that he had been cheated by S, who –as is usual in such cases - has vanished from the scene. C thinks, that B should have given him more information on S, the property prices and the rents achievable. C claims damages from B.

First question of course is: Has C in fact been cheated? Customers should know that people like S want to sell their products; they tend to exaggerate and to create hopes, which are not always well based. BGH dd 19.9.06 says: Only factual statements, the verity of which can be proved or disproved, can, if wrong, at all be the basis of any damage claim. Assuming, the statements of S were factual in this sense and that they were wrong. What has B to do with it? In principle nothing.

Question therefore is: Was B under any obligation to act? A bank may sell her loan to clients according to her own business practices; B is under no obligation to inquire as to what the client wants to do with this money. And even if the bank knows that the client is about to pay far too much - it is not her business to warn him.³ After all there may be stipulations in the contract between Seller and Client which would make up for the apparent imbalance of price and market value of the purchased good. Even if B knew that S had been telling stories to C about investment, it is not her business to interfere. So an obligation to act or to do something in favour of C only arises if B knows something important, what C does not know (*konkreter Wissensvorsprung*).

In this case B did not have the special knowledge. Then come the question: Was B under an obligation to find out? There are in all jurisdictions cases in which acts of one person can legally be imputed to another person. This is generally so in a relationship of master and servant (*Geschäftsherr und Gehilfe*, §§ 278, 831 BGB; Art. 1384 Code Civil). However, S in the above case was *not* the servant of B. Nevertheless BGH reasons: If there is a steady and close business relationship between B and S (*institutionalisiertes Zusammenwirken*) B should

² The following cases which have been decided by BGH have for this example been amalgamated to one: Dd 19.9.06, WM 06, 2343; dd. 26.9..2006: WM 06, 2347; 21.11.06 WM 07, 200.

³ There are, however, certain exceptions to this rule. Whenever it is blatantly clear that C is deceived, then B is obliged to warn C; e.g. the bank sees, that the price which client is about to pay is in the range 100% above the market price. But this has nothing to do with B and S working together or not – this obligation to inform or warn would follow *bona fide* out of the loan agreement. As a general rule: Partners to a contract owe each other that amount of help which is conducive to a bona fide operation of that contract. see generally: Koller ZBB 07, 197: *Zu den Grenzen des Anlegerschutzes bei Interessenkollision*.

know that S is doing and if B does not know, B is obliged to inform herself. Hence, BGH has *praeter legem* created a presumption (*Vermutung*) to the effect that Bank is treated as if she the above mentioned *Wissensvorsprung*, *special knowledge*, and from this follow that B should have informed C.

As this is a presumption, Bank may therefore undertake to prove that she indeed did not know, in what business practices S was indulging. It is evident, that such a proof is not fully but almost impossible; in any case it is fairly easy to prove a positive fact , e.g. to prove that the car is in this town; and very difficult to prove something negative, i.e. to prove that the car is nowhere in town.

The important question is: what is meant by *institutionalisiertes Zusammenwirken*? Various theories are forwarded; but we should wait and see what the courts make out of this fairly new concept.

IV. Failed Investments – Verletzung von Aufklärungspflichten

Example:⁴

Client C had been a customer of bank B for more than 20 years and had saved 55.000 DM. This money had always been invested in save investments like state securites (*Bundesschatzbriefe*) and savings accounts. After repayment of DM 20.000 of part of his investments C asks B for advice how to reinvest this sum. B shows to C inter alia a list which includes bonds of the Bond – Finance Ltd, which had been initiated by the then famous Australian tycoon Bond. C buys these bonds in March 1989.

In June 988 the Australian Rating Agency had already downgraded the Bond – bonds to BB as being “speculative”, and in December 1988 these had further been downgraded to CCC as “ highly” speculative. In March 1989 these bonds had just been listed in the Frankfurt stock exchange. Mr Bond was later put to jail; the bonds of C are worthless.

C claims damages from B, which are granted by BGH.

Was B under an obligation to *do* something in favour of C? Basis of the claim is a contract. BGH assumes that an unspecified contract had tacitly been agreed between C and B, under which B was obliged to give C such advice on the intended investment as suits the purposes of C as these can be ascertained by B (*anlegeregerecht*). B knew that C was a conservative investor with little experience in financial questions. If B offers a highly speculative investment B must inform C on this. Of course C wants high yields, which usually go with a speculative investment, but B must inform C about the higher risk of losing his money altogether.

B`s argument was: We did not know about the downgrading of the Bond – bonds, we trusted in the fact that these had just been listed in Frankfurt. This argument was not accepted by BGH. The German Supreme Court ruled that B should have known:

⁴ BGH v. 6. 7. 93 WM93, 1455 (Bond – Anleihe)

Information given by B must be correct and diligent. Diligence implies that B knows what she is offering or recommending to C. If B does not know she should usually refrain from offering this paper and must warn C about the risk of investing in a paper on which so little is known.

If, however, B chooses to offer or even recommend a paper, B is under a contractual obligation (*bona fide* or: *Nebenpflicht § 242BGB*) towards B thoroughly inform herself. This means that B must take notice of all information and publications pertaining to the respective financial product. If this is foreign product grade of necessary diligence for B therefore is even higher. B must consider that C usually does not have access to sources by which he can information by himself.

B could not rely on the fact that the Bond - bonds were listed with the Frankfurt exchange, the less so as the respective prospectus showed a high debt/equity ratio.

Conclusion

It goes without saying, that the jurisprudence is always developing. There is a continuous flow of court rulings on the subject. I have counted in 2007 alone some 15 verdict from BGH and lower courts.⁵ Sometimes these add to the precision of the concept, and sometimes they do not. In principle it may be said, however, that the above examples reflect the present state in Germany.

⁵ see: ZBB from December 2006 till September 2007