

# Application of the *Braganza* Duty When Closing out a Trading Account

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## Key Takeaways

- The High Court has considered the application of the *Braganza* duty to the closeout of a spread betting account.
- The *Braganza* duty requires a decision maker to exercise its discretion honestly, in good faith and in the absence of arbitrariness, capriciousness, perversity and irrationality.
- The court will consider detailed evidence and the circumstances in the round where a decision maker is alleged to have breached its *Braganza* duty.
- It is important to implement and evidence robust processes and procedures when offering services to individuals or other persons in which a decision maker may exercise a discretion in order to best protect all parties

**Introduction.** In *CMC Spreadbet PLC v Tchenguiz* [2022] EWHC 1640 (Comm) the High Court considered the *Braganza* duty in deciding whether a spread betting firm had breached its duty to act rationally and reasonably in exercising its discretion to close out and to liquidate an individual's trading account. In summary, the court found that the firm had not breached the statutory, regulatory or *Braganza* duties it owed the defendant. The firm had given the defendant sufficient warnings concerning his voluntary reclassification from retail to professional investor. It had not acted arbitrarily or unreasonably in refusing security (but not full top-up payment) that he offered to stabilise his trading account, under conditions of market volatility during the COVID-19 pandemic.

**The Facts.** The parties entered a spread betting agreement (the "SBA"), and in the course of trading, the defendant incurred losses of £1.3m. (Spread betting is a form of contract for differences. It allows the parties to speculate on the occurrence of future events, typically price movements in markets.) The claimant, a spread-betting firm,

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sought to recover a debt (or alternatively a sum payable in contract) from the defendant, which the defendant resisted on two principal bases.

First, the defendant alleged that the claimant had breached its duties under the Financial Conduct Authority's Conduct of Business Sourcebook's Rules when it categorised him as an elective professional client rather than as a retail client. The defendant alleged that the claimant did not give him the warnings it was required to provide regarding the loss of protections resulting from his reclassification from retail to elective professional client.

Second, the defendant alleged that if the claimant had been entitled to classify him as an elective professional client, then the claimant acted in a *Braganza* irrational manner in closing and liquidating his trading account in the manner it did. He also alleged that the claimant had failed to act in his best interests under the Conduct of Business Source Rules and that the claimant was in breach of an implied term that it would close out the defendant's account in accordance with reasonable market practice. If these allegations were made out, the defendant's counterclaim would entitle him to damages against the claimant under s. 138D of the Financial Services and Markets Act 2000, which would establish an equitable set-off equivalent to the claimant's claim. In other words, the set-off would wholly extinguish the claimant's claim.

**The Judgment.** The court rejected the first part of the defendant's defence. It found that the claimant had not breached its duty to warn the defendant about the disadvantages of him being re-categorised from retail to professional client. The reclassification as an elective professional client was proper. This conclusion was supported by evidence that the defendant had willingly agreed to it.

As to the second part of the defence concerning the defendant's allegations that the claimant was in breach of duty, including the *Braganza* duty, the court considered Baroness Hale's speech in *Braganza v BP Shipping Ltd* [2015] 1 WLR 1661 and her approval of Rix LJ in *Socimer International Bank Ltd v Standard Bank London Ltd* [2008] EWCA Civ 116 that:

*a decision maker's discretion will be limited, as a matter of necessary implication, by concepts of honesty, good faith, and genuineness, and the need for the absence of arbitrariness, capriciousness, perversity and irrationality.*

Baroness Hale in *Braganza* held that Rix LJ's approach as set out in *Socimer* had two limbs:

*The first limb focuses on the decision-making process – whether the right matters have been taken into account in reaching the decision. The second focuses on its outcome –*

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*whether, even though the right things have been taken into account, the result is so outrageous that no reasonable decision-maker could have reached it.*

In applying *Braganza*, Elvin J considered evidence regarding the circumstances in which the claimant had closed out the spread-betting account. Due to the market volatility arising out of the COVID-19 pandemic, the price of certain shares dropped very quickly, which required the defendant to deposit further funds into his account under the SBA to keep it above call levels. Whilst making a part payment, the defendant did not provide sufficient additional funds to maintain his account above the call levels. He attempted to provide security instead, but for reasons discussed below, this was not acceptable to the claimant. The claimant therefore manually closed out the defendant's account without further delay, which the defendant alleged meant that he lost the chance he otherwise would have had to reduce his losses.

The court examined the terms of the SBA. Under them, the claimant in its sole discretion could seek to contact the defendant to request additional payments before closing out his trading account. However, if he could not be reached, or he could not make payment on account within a reasonable time, then the claimant was entitled to close and liquidate the account – partially or fully. On the evidence, the court considered that the claimant had entered a dialogue with the defendant and had not immediately acted unilaterally. The fact remained that the defendant did not make full payment of the amounts required to maintain his account above the call value.

Elvin J found that the claimant was justified in rejecting the security the defendant offered, which amounted to a beneficial interest in several discretionary trusts. Under the terms of the trusts, although the trustees had no obligation to assist the defendant, they could elect to do so. Further, the beneficial interests were neither cash assets, nor were they readily able to be liquidated. Taking account of all these considerations, the court found that it was not irrational or unreasonable for the claimant to reject the security the defendant offered when they asked him to top up his trading account. Nor was it irrational or unreasonable for the claimant to close out and proceed to liquidate the defendant's account.

The court also rejected the notion that the claimant was in breach of an implied term that the closeout of the defendant's account must be in accordance with reasonable market practice. Not only was it not necessary to imply such a term into the SBA, there was insufficient evidence of market practice to make sense of such an implied term. As for the allegation that the claimant had breached its duty under the Conduct of Business Source Rules to act in the best interests of its client, this, strictly speaking, did not arise as the duty does not apply to cases of closeout because of a failure to meet a margin call. If it had applied, the Judge was prepared to find that the claimant had discharged its duty.

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**Going Forward**

- Although *Braganza* reasonableness (like *Wednesbury* reasonableness) does not hold decision-makers to a very high standard, parties can protect themselves from claims for breaching it by having procedures and processes in place for the exercise and enforcement of contractual rights.
- In regard to accepting security instead of cash payments, it appears that a creditor or firm can, without breaching *Braganza* duties, reject proposed security for a variety of reasons including it not being vested in the party offering it or it being illiquid or in a discretionary trust.
- Conversely, parties seeking to rely on *Braganza* must be aware of the challenges in doing so where there is an absence of significant failures of process or outcome.

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Please do not hesitate to contact us with any questions.

*We would like to thank trainee associate Scott Morrison for his contribution to this Debevoise Update.*

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