Hard Cases

The Duty to Inform and Voidable Investment Orders

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Abstract

The definition of the relationship between framework contracts and individual investment orders has always been the subject of debate both in legal scholarship and in case law, as it is functional to the solution of various application issues. One of these is the identification of a remedy available to a client in the event of the intermediary's non-compliance with the obligations to obtain information. Once again, the Supreme Court has ruled on this question in a way that differs from previous perspectives, by opening itself up to considering the economic operation as a whole in procedural terms, which is particularly useful in clarifying the position of the intermediary in the light of the duty to protect the best interests of the client, as prescribed by Art 21 of the TUF (Financial Services Act).

I. The Ruling

The Italian Court of Cassation was called upon to decide on the lawfulness of the decision handed down by the Court of Appeal of Florence regarding a claim brought against a credit institution by a client. It concerned avoidance of contract for a breach regarding an individual investment. In the case at hand, this involved the purchase of financial instruments in violation of the obligations to obtain information imposed on the intermediary. The Court of Appeal rejected the request due to the purely executive nature of the order. Thus, it concluded that voidance should concern the framework contract and not the individual order and that, therefore, the existence of the requirement of severe breach of contract referred to in Art 1453 of the Italian Civil Code should be assessed in relation to the total value of the investments.[1]

Defining the relationship between framework contracts and individual investment orders has always been the subject of debate in both legal scholarship and case law, as it is functional to the solution of various application issues:

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[1] Avoidance for breach of contract is regulated by Arts 1453 et seq of the Italian Civil Code. In particular, Art 1453 provides that 'in contracts providing for mutual counterperformance, when one of the parties fails to perform his obligations, the other party can choose to demand either performance or dissolution of the contract, saving, in any case, compensation for damages' (J.H. Merryman et al, *The Italian Civil Code and Complementary Legislation* (New York: Oceana, 2010)). Art 1455 Civil Code, states that 'a contract may not be terminated if the non-performance of one party is of little importance compared to the interests of the other'.

from the form required for an order to be valid, to the consequences of failing to respect the obligations to obtain information imposed on financial intermediaries to protect investors, to the nature of the liability of the intermediaries themselves when such a violation occurs.[2]

Within the space of a few months, the Supreme Court has once more taken a position on all these issues, namely on the form,[3] and specifically on the remedies,[4] available if an intermediary undertakes an investment transaction in violation of the rules of conduct dictated by the Financial Services Act (TUF)[5] and the Consob Regulations[6] implementing the primary provision. In other words, where the common ground that unites the accepted solutions is precisely the definition of the current relationship between the framework contract and individual orders.

The ruling in question states in no uncertain terms that both the framework contract and the individual orders are of a contractual nature. It is undeniable that both investment or divestment orders are contractual, as they express, in themselves, the client's interest, which the transaction as a whole represents.

Regarding the remedies available in the event of the breach of the obligation to obtain information, the order would therefore be annulled with respect to the framework contract.[7] The order represents the implementation phase of the contract, not only in terms of its concrete execution, but also being the means by which the investment decision is expressed. Therefore, it should be possible to annul it. A violation of the rule imposing the obligation to obtain information constitutes none other than a breach of contract.

The Court of Cassation states that its ruling represents the continuation of a previous approach. This is undoubtedly true. Nevertheless, the main passages of the Court's judgment, with explicit recognition of the existence of a procedural sequence putting into effect only the client's interest in the investment, seem to

[2] For a summary of all these issues, see M. Maggiolo, 'Servizi ed attività d'investimento. Prestatori e prestazioni', in A. Cicu and F. Messineo eds, *Trattato di diritto civile e commerciale* (Milano: Giuffrè, 2012); and B. Inzitari and V. Piccinini, 'La tutela del cliente nella negoziazione di strumenti finanziari', in B. Inzitari eds, *Il diritto degli affari* (Padova: CEDAM, 2008).

[3] Corte di Cassazione 30 November 2017 no 28816, available at www.dirittobancario.it.

[4] Most recently, Corte di Cassazione 24 May 2017 no 12937, available at www.dirittobancario.it. But see also Corte di Cassazione 3 May 2017 no 10713, available at www.dirittobancario.it.

[5] Consolidated Law on Financial Intermediation implementing EU-derived regulations, adopted through decreto legislativo 24 February 1998 no 58.

[6] The National Commission for Companies and the Stock Exchange (Consob) is the Italian supervisory authority for the financial markets and is also responsible for issuing the regulations implementing the Consolidated Finance Law (TUF). Those mentioned in the text are, in order, the *Regolamenti Intermediari Consob* 11522/1998, 16190/2007, and 20307/2018.

[7] The remedy referred to in the text is governed by Arts 1453 et seq. of the Italian Civil Code. In the Italian system, this remedy must be distinguished from both nullity (Art 1418 Civil Code) and voidability (Arts 1425 et seq. Civil Code), which constitute possible causes of invalidity of an act, namely, where the remedy under Art 1453 Civil Code can be applied in case of malperformance during the execution of the contractual relationship.

express a new approach to the framework of the transaction itself.

II. The Reasons for the Decision Concerning Safeguards

The tendency to favour the annulment of investment orders in case law undoubtedly stems from the repeated statement by the United Sections of the Court of Cassation of the distinction between the rules of validity and the rules of conduct and their importance in identifying the instruments available to protect investors.[8]

The ruling and its contents are well known. Equally well known is the national and international financial context behind it. In the wake of Argentina's bankruptcy and that of a number of Italian companies that had otherwise been considered fairly solid, those who had bought securities in the first and shares in the second sought to take legal action against credit institutions in order to recuperate their investment on the grounds of the invalidity or the voidability of the purchase contracts.[9] Some trial judges accepted these claims, declaring the

[8] This is the well-known Corte di Cassazione-Sezioni unite 19 December 2007 no 26724, *Foro italiano*, I, 785 (2008), which is also much commented on in legal scholarship. Among the more critical commentaries, see A. Gentili, 'Disinformazione e invalidità: i contratti di intermediazione dopo le Sezioni unite' *Contratti*, 393 (2008); and D. Maffeis, 'Discipline preventive nei servizi di investimento: le Sezioni Unite e la notte (degli investitori) in cui tutte le vacche sono nere' *Contratti*, 403 (2008).

Essentially, the debate stems from the more traditional belief that the distinction between rules of validity and rules of conduct is counterbalanced by the distinction between contractual remedies and remedies concerning the legal relationship. From this perspective, the majority of legal scholars affirm that when a rule of conduct breached (ie, a rule that establishes obligations to be fulfilled in the course of the execution of the contractual relationship), invalidating remedies, such as, for example, nullity and voidability, are never available. Rules of conduct, for example, impose the obligation to obtain information or are discerned by interpretation from the general provision on good faith. On the other hand, rules of validity, the violation of which could be followed by the application of an invalidating measure, identify a structural or content requirement for the validity of an act. On this, see for example, G. D'Amico, *Regole di validità e principio di correttezza nella formazione del contratto* (Napoli: Edizioni Scientifiche Italiane, 1996); V. Roppo, 'Contratto di diritto comune, contratto del consumatore, contratto con asimmetria di potere contrattuale: genesi e sviluppo di un nuovo paradigma', in Id, *Il contratto del duemila* (Torino: Giappichelli, 2002), 46. More recently, for a critical approach on this distinction, G. Perlingieri, *L'inesistenza della distinzione tra regole di comportamento e di validità nel diritto italo-europeo* (Napoli: Edizioni Scientifiche Italiane, 2013).

[9] Under the Italian system, nullity and voidability are associated with invalidity and differ in terms of the interest they serve: one for the protection of a general interest, the other an individual interest. On the basis of this distinction there are some substantial differences regarding the way action is regulated and the legality of the effects of the act. Thus, with regard to nullity, an action is not subject to time limits, the flaw is noted *ex officio* and the act cannot be validated. Regarding voidability, on the other hand, the action is time-barred, the flaw cannot be noted *ex officio* and the deed can be validated. The need for strict correspondence between the remedy and the applicable discipline in these terms has, however, long been the subject of debate. In the recent past, perhaps in the wake of the introduction into the Italian system of so-called 'protective nullity' (*nullità di protezione*) of EU origins, the subject has sparked new

above-mentioned contracts void on the grounds of violation of the obligation of intermediaries to obtain information.[10] In their view, the infringement in question was one of virtual invalidity under the first paragraph of Art 1418 of the Italian Civil Code.[11]

The United Sections responded to these pronouncements by precisely reiterating the classic distinction between the rules of conduct and the rules of validity, explicitly specifying the scope of the latter. Accordingly, the remedy for invalidity can only be applied in the event of a breach of a rule imposing a requirement of the act, unless the lawmaker provides otherwise. In this case, the breach of a rule of conduct, of which the obligation to obtain information is an example, only gave rise to the right to claim damages.

Once the invalidity option was rejected, the case law sought other remedies, equally capable of giving the clients legal satisfaction. In reality, the Joint Divisions themselves paved the way for the annulment option. The possibility that there is anything in the discipline on investment services that presumes the will on the part of the lawmaker to treat the rules of conduct in the same way as the rules of validity was excluded. Then, the Court of Cassation stated that if violation of the obligations that precede the stipulation of the mediation agreement brings with it pre-contractual responsibility on the part of the credit institutions, there can be no doubt that a breach during the execution phase gives rise to contractual liability,

> 'since those duties, albeit of legal origin, derive from mandatory rules and are therefore intended to supplement the rules in force between the parties to all effects'.[12]

It is a short step from breach of contract to the annulment of the individual order. Other rulings followed from this one, specifying with even greater clarity that a breach of the obligation to obtain information downstream of the framework contract can give the client the right to seek its annulment as well as that of individual orders where there is a specific interest.[13]

interest: see, more recently, G. Perlingieri, *La convalida delle nullità di protezione e la sanatoria dei negozi giuridici* (Napoli: Edizioni Scientifiche Italiane, 2011).

[10] See, for example, Tribunale di Mantova 18 March 2004, *Banca, borsa, titoli di credito*, II, 440 (2004), with a comment by D. Maffeis, *Conflitto di interessi nella prestazione di servizi di Investimento: la prima sentenza sulla vendita a risparmiatori di Obbligazioni argentine*.

[11] In particular, the first para of Art 1418 Civil Code states that, 'A contract that is contrary to mandatory rules is void, unless the law provides otherwise' (J.H. Merryman et al, *The Italian Civil Code and Complementary Legislation* (New York: Oceana, 2010)).

[12] Corte di Cassazione-Sezioni unite 19 December 2007 no 26724 n 8 above, 785.

[13] Among the more recent, Corte di Cassazione 6 November 2014 no 23717, available at www.dejure.it; Corte di Cassazione 27 April 2016 no 8394, available at www.dejure.it.

III. The Objections Raised in Much of the Legal Scholarship to the Annulment of an Order Due to Violation of the Obligation to Obtain Information

Once the remedy had been identified, legal scholars turned their attention to its theoretical feasibility, finding many obstacles, ranging from the nature of the orders themselves to extending the requirement obtain information to its execution phase, as well as to that of the framework contract.[14]

On the nature of orders, the picture is quite complex. There are essentially two schools of thought: one that denies their contractual nature and one that accepts it. Thus, the possibility of annulling the order on the assumption that the framework contract follows the pattern of the mandate is rejected both by those who consider it a strictly legal act, given that it is an instruction from the client, and those who prefer to refer to the implementation agreement. The order would thus have an impact on the execution phase of the framework contract, where its causal aspect emerges.[15]

Conversely, annulment is deemed possible, at least in abstract terms, by those who, considering the framework contract as a normative framework,[16] attribute to individual orders the nature of actual orders to sell or buy,[17] or as offers to sell or buy,[18] depending on whether they are trading on behalf of

[14] The subject of the relationship between the framework contract and the individual order has been addressed by various scholars: among others, see F. Galgano, 'L'inadempimento ai doveri dell'intermediario non è, dunque, causa di nullità virtuale' *Contratto e impresa*, 579 (2006); Id, 'I contratti di investimento e gli ordini dell'investitore all'intermediario' *Contratto e impresa*, 889 (2006); A. Luminoso, 'Contratti di investimento, mala gestio dell'intermediario e rimedi esperibili dal risparmiatore' *Responsabilità civile e previdenza*, 1422 (2007); V. Roppo, 'La tutela del risparmiatore fra nullità, risoluzione e risarcimento (ovvero, l'ambaradan dei rimedi contrattuali)' *Contratto e impresa*, 896 (2006); A. Perrone, 'Regole di comportamento e tutele degli investitori. Less is more' *Banca, borsa, titoli di credito*, 537 (2010). For an effective summary of the terms of the issue A. Tucci, 'Il problema della forma dei contratti relativi alla prestazione dei servizi di investimento' *Rivista trimestrale di diritto dell'economia*, II, 39 (2009). Recently on the subject see also G. Berti de Marinis, 'L'invalidità formale nei contratti di investimento' *Banca, borsa, titoli di credito*, 37 (2013), and G. Conte, 'Forma e sostanza nei contratti aventi a oggetto prestazioni di servizi di investimento' *giustiziacivile.com*, 18 October 2017.

[15] For this line of thought, see especially F. Galgano, *L'inadempimento* n 14 above, 579; Id, *I contratti di investimento* n 14 above, 889.

[16] Albeit with different nuances, before and after MiFID directive see M. Lobuono, *La responsabilità degli intermediari finanziari* (Napoli: Edizioni Scientifiche Italiane, 1999), 106; A. Perrone, n 14 above, 537; P. Lucantoni, 'L'inadempimento di 'non scarsa importanza' nell'esecuzione del contratto c.d. quadro tra teoria generale della risoluzione e statuto normativo dei servizi di investimento' *Banca, borsa, titoli di credito*, II, 783 (2010). In terms of effectiveness, the special feature of a framework contract is that the parties only identify the *content* of future contracts and are not obliged to enter into them.

[17] In this sense see especially the case law: among the many cases, Tribunale di Monza 4 June 2008, *Rivista trimestrale di diritto dell'economia*, II, 21 (2009), with a commentary by A. Tucci, n 14 above, 39.

[18] Overall, V. Roppo, *La tutela del risparmiatore* n 14 above, 896.

others or for themselves.

However, also from this point of view, the practicalities of the solution accepted in case law in the event of a breach of the obligation to obtain information are still problematic. The emergence of these obligations for intermediaries is very often linked to framework contracts, as they, being legal obligations, add only to the effectiveness of the contract. Regarding the remedies available in the event of non-execution, therefore, any action for termination should be directed against it alone, and not the order, for which the conditions laid down in Art 1455 of the Italian Civil Code apply. Regarding the order, the obligation to obtain information arises at the stage when the relationship is formed, so that any breach would be a matter of pre-contractual responsibility, in accordance with the provisions of Art 1337 of the Italian Civil Code.[19]

All these issues are only briefly mentioned in the ruling in question. What it says is, however, central to the question of the remedies available for individual orders. It concerns, first and foremost, the link between orders and the framework contract stipulated upstream.

If it is true that one of the most significant difficulties in terms of the possibility of annulling orders is first of all the extension of the legal obligations in place to safeguard the client's interests to the execution phase of the framework contract; it is also true, however, that this extension presupposes that those who recognise the contractual nature of the order see the whole question in terms of the connection between the two acts, namely between two contracts, which are, however, autonomous from the functional point of view.

It is this interpretation that the Court of Cassation contests, clearly deeming the relationship between the framework contract and individual orders as

> 'a contractual agreement involving a sequence that, being designed as a whole and intending (...) to protect the investor's position (in line with the constitutional principle of safeguarding savings under Art 47 of the Italian Constitution), unfolds in several consecutive stages'.

After this statement, the Court develops its reasoning along two basic lines: on the one hand, it sees the function of the framework contract as the same as that of the individual orders, and on the other, it focuses on the legal framework for protecting investment services. Within this framework, the brokering function takes on a particular importance that runs through the entire relationship between the intermediary and the client, which is best expressed in the choice of an individual investment.

[19] See ibid.

IV. Conceptual Presuppositions for Rejecting the Annulment of an Order. The Functional Peculiarities of Trading in Financial Instruments

It should immediately be observed that framing the issue in procedural terms would mean abandoning the use of traditional conceptual schemes in order to define the relationship between the client and the intermediary. Furthermore, from this perspective, it would be more appropriate to see the question as one of duty of care, as those who see the intermediary as an actor under private law[20] do In terms of remedy, it would be more logical to refer to ineffectiveness rather than contract avoidance,[21] considering that the execution of an inadequate or inappropriate order primarily causes, from the procedural perspective, the loss of the functional link between acts serving the same purpose, being the best investment for the client.[22]

Thus, the importance of the ruling in question remains unchanged, considering the functional framework of the situation it has created as a whole. Moreover, recognition of the importance of the aspect of agency could also be useful to avoid the contract under certain circumstances.[23]

On the functional level, therefore, the framework contract undoubtedly establishes the rules of future agreements. In this sense, the secondary regulation is clear in its identification of minimum content when specifying the services provided and their characteristics, as well as the methods by which the order is to be made and the fees due to the intermediary. However, it is also true that the conclusion marks the moment when the relationship between intermediary and investor is specified in relation to the investments for which it is preparatory. Thus, it is in the framework contract that the client's general interest in the

[20] R. Di Raimo, 'Fisiologia e patologia della finanza derivata, Qualificazione giuridica e profili di sistema', in F. Cortese and F. Sartori eds, *Finanza derivata, mercati e investitori* (Pisa: Edizioni ETS, 2011), 66; Id, 'Dopo la crisi, come prima e più di prima. (Il derivato finanziario come oggetto e come operazione economica)', in D. Maffeis ed, *Swap tra banche e clienti. Le condotte e i contratti* (Milano: Giuffrè, 2013), 37; Id, 'Finanza, finanza derivata e consenso contrattuale, a valle delle crisi d'inizio millennio' *Giustizia civile*, 1106 (2015), and Id, 'Ufficio di diritto privato, natura del «potere» dispositivo, e fondamento variabile dell'iniziativa negoziale', in S. Ciccarello, A. Gorassini and R. Tommasini eds, *Salvatore Pugliatti* (Napoli: Edizioni Scientifiche Italiane, 2016), 457. See, from another perspective and with different results from the objective assessment of the intermediary's work, D. Maffeis, 'L'ufficio di diritto privato dell'intermediario e il contratto derivato *over the counter* come scommessa razionale', in D. Maffeis ed, *Swap tra banche e clienti. Le condotte e i contratti* (Milano: Giuffrè, 2013).

[21] In the Italian system, ineffectiveness occurs when the act is neither null nor voidable, but nevertheless produces no effects. This category is heterogeneous as ineffectiveness may arise from many factors. For example, the failure of an event to occur, but upon which the effectiveness of the act rests, or, as in the case in point, the lack of entitlement to act on the part of a person who is responsible for the care of the interests of others. The difference compared with avoidance therefore lies in the unfitness of the contract to produce legal effects from the outset.

[22] For some further reflection on this point, see section seven below. For further bibliographical references, see the previous note.

[23] See section six below.

investment is expressed to the full, and the method of specification is expressed significantly in the rule in Art 21 TUF, which states that

> 'in the provision of investment and ancillary services and activities, the authorised parties must: a) behave with diligence, fairness and transparency, in order to best serve the interests of clients and for the integrity of the market'.

In terms of effectiveness, therefore, it does not seem possible to relegate this contract to the mere framework level,[24] given that only when it has been stipulated is the current legal relationship between the parties involved established and specified in the sense mentioned above.[25] Basically, through this means, the intermediary and the client establish the rules of their future relations but not only in the terms in which this would develop using a framework contract in the traditional sense. By stipulating the contract, the parties direct the future of the relationship they have just established towards the realisation of the client's interest in the investment. This realisation is expressed through a procedural process studded with legally imposed duties on the intermediary; they too are instrumental in the implementation of the primary regulation contained in Art 21 TUF.

On the other hand, and in line with the Court of Cassation's interpretation of the matter as a whole, the framework contract and its effects cannot be isolated from the subsequent acts that make the investment a reality during the course of the operation, since it does not seem realistic to limit the importance of the individual investment to the subsequent agreement between the intermediary and the customer alone. The opinion that recognises the causal autonomy of these contracts is certainly to be upheld given that framework contracts are signed exclusively for the purpose of protecting the customer.[26] Yet precisely because an individual investment is not merely the execution act of a framework contract, it is at least logically possible to distinguish a further aspect regarding agents and their care of the interests of others, namely the specification of their clients' interests.

From this perspective, at least from the logical point of view, the investment

[24] Cf A. Perrone, *Regole di comportamento* n 14 above, 537.

[25] In this respect, it could be possible to have recourse to the category of organisational effect, on which see P. Ferro-Luzzi, *I contratti associativi* (Milano: Giuffrè, 1972), 170; R. Di Raimo, 'Considerazioni sull'art. 2645 ter Civil Code: destinazione di patrimoni e categorie dell'iniziativa privata' *Rassegna di diritto civile*, 953-957 (2007).

[26] Moreover, if the framework contract is null and void due to the lack of the client's signature, the expiration of the order and, with it, the investment that would follow despite respecting the legal safeguards, would depend not on the absence of a valid cause justifying the transfer of assets, but on a precise legislative decision that sees the framework contract as a condition for validity: thus A. Tucci, *Il problema della forma dei contratti relativi alla prestazione dei servizi di investimento* n 14 above, 39.

transaction is divided into a minimum of three phases. The first is completed when the framework contract, which, as we said, sets the rules for future trading in financial instruments, is signed, officialising in particular the client's general interest in the investment, necessarily specified by the intermediary. The second is the transactional aspect of the operation, as it is here that the choice of the single investment is made, and the client's specific interest in the investment finally becomes explicit. The third is the material selection process, performed through a bilateral or unilateral act, depending on the characteristics of the investment service,[27] whereby it takes concrete shape.

The need to recognise a specific moment in which the concrete interest in an individual investment can be identified is understood in the context of the peculiarities of trading in financial instruments, for which the traditional rules regarding intermediaries in terms of the classic mandate model need some adjustments.

The difficulty in reconstructing the complex relationship between the parties, which undoubtedly comes into being when the framework contract is stipulated, is precisely this: the investor's interest in a given transaction is clearly expressed only at a later stage and through the action of the intermediary.

Of course, the financial instruments for carrying out an investment are not all the same and often have different complexities. Nor are, by the same token, all investment services the same. This is reflected in the diversity of the rules of conduct imposed on the intermediary according to the type of service and the objective riskiness of the financial instrument. Nevertheless, identifying the client's specific interest, manifested through the execution of the order, is always postponed to a later date.

V. Agency and the Contractual Process

On the regulatory level, apart from the mere execution of orders,[28] the

[27] V. Roppo, 'Sui contratti del mercato finanziario, prima e dopo la MiFID' *Rivista di diritto privato*, 498 (2008). The admissibility of a structurally unilateral act with attributive effect see P. Perlingieri, *Il diritto civile nella legalità costituzionale secondo il sistema italo-comunitario delle fonti* (Napoli: Edizioni Scientifiche Italiane, 2006), 605. With particular reference to the management of an interest of others see M. Semeraro, *Acquisti e proprietà nell'interesse del mandante* (Napoli: Edizioni Scientifiche Italiane, 2011), 175.

[28] It must however be pointed out that, with regard to the regime *before* the Mifid case, the case law already considered the intermediary obliged to inform the client of the characteristics of the financial instrument and to evaluate the appropriateness of the operation in relation to its Italian interest even when merely carrying out orders: Corte di Cassazione 1 February 2018 no 2523, and Corte di Cassazione 23 September 2016 no 18702, both available at www.dirittobancario.it. Concerning the current regulations, the issue to be resolved clearly regards the extension of the scope of consultancy: F. Sartori, 'Autodeterminazione e formazione eteronoma del regolamento negoziale. Il problema dell'effettività delle regole di condotta' *Rivista di diritto privato*, 93 (2009); M. Semeraro, 'Rischio di impresa bancaria e discipline recenti' *Giustizia civile*, 866 (2016).

above-mentioned collaboration of the intermediary for the purpose of specifying the interest in the investment is expressly recognised in some of the rules of conduct to which s/he is subject, normally applied to the execution phase of the framework contract. The obligations they impose are supposed to reinforce the effectiveness of the contract, so a serious failure to fulfil them could be a ground for termination.[29]

Doubtless, some of the rules of conduct are immediately applicable as soon as the framework contract has been stipulated. For example, those that impose the so-called passive and active obligations to obtain information, meant to clarify the clients' specific interest and help them make informed choices. Nevertheless, the identification of the clients' specific interest, which is implemented through the execution of the order, is always postponed to a later date.

Once again, on the logical level, it is therefore necessary to further distinguish between the phase in which the client's specific interest is identified and the assessment phase before carrying out the investment transaction.

This is confirmed by the undoubted inapplicability of some of the rules on mandate regarding the relationship between intermediary and client, rules that express a synthesis of the interests of the principal and the agent that is difficult to harmonise with the characteristics of trading in financial instruments. One example is Art 1712 of the Italian Civil Code, which grants the principal a period of time within which to assess whether the deal is really in his or her interest, even in cases where the agent has departed from the instructions imparted or exceeded the limits of the mandate. Another example is Art 1715 of the Italian Civil Code, which rules out the possibility of holding an intermediary liable to the principal for the fulfilment of obligations assumed by third parties with whom s/he has entered into a contract, unless s/he was aware, or ought to have been aware, of the party's insolvency when signing the agency agreement. Both these provisions express rules of risk distribution that can be considered rational and reasonable only from the point of view of the acknowledged ability of both parties, especially the principal, to be *in full control* of their own interests.[30]

When it comes to trading in financial instruments however, the situation is reversed. The investors, in fact, rely on the intermediary not only to look after their interests, but also to define them.[31] Entry into a framework contract is meant to underpin this very relationship of trust. Regarding the distribution of risk, and considering the element of chance characterising every type of investment, from the simplest to the most complex, and the fact that any assessment of the intermediary's conduct can only be based on the relevant

[29] On the five duties that would continue to be imposed on the intermediary also post-Mifid, see A. Gentili, 'Disinformazione e invalidità: i contratti di intermediazione dopo le Sezioni unite' *Contratti*, 393 (2008).

[30] M. Semeraro, *Acquisti e proprietà* n 27 above.

[31] R. Di Raimo, *Dopo la crisi, come prima e più di prima* n 20 above, 37; Id, *Ufficio di diritto privato* n 20 above, 457.

concrete result obtained, what is achieved by balancing the client's interests and those of the intermediary can certainly not be made to depend on applying the principle of responsibility for oneself.[32]

Ultimately, once the client's aptitude for investment has been ascertained, and with it, the types of investment that best suits his or her interests, the next step is not chosen by the investor alone. The intermediary plays a role in this, providing the necessary information on the characteristics of the financial instrument and its degree of riskiness, also assessing whether it corresponds to the aforementioned interest. The only exception to this is the so-called 'mere execution of orders', and here too clients are not completely devoid of protection, as they must be duly informed of the fact that the intermediary will proceed with the investment without the obligation to fulfil the so-called passive obligations to obtain information.[33]

VI. Reflections on Client Protection. The Annulment of an Order

The complex investment process therefore includes a) establishing the client's general interest in the investment, b) the client's specification of the choice of investment, c) the assessment of this choice and, finally, d) its execution.

The general interest, it is now clear, is expressed through the framework contract. This is this the means by which, to reiterate, the relationship between investor and intermediary is formalised. This relationship is particularly marked by the importance of the interest in the light of the principles of the system, namely, in the light of the principle of the protection of savings enshrined in Art 47 of the Constitution. This importance lies in the characteristics of the intermediary's position in relation to the client, and therefore can be recognised in the area of practical action and not only in the action of the others' interests. This particular importance also explains the logical need for the pre-existence of the framework contract as an agreement between the parties which, in identifying the rules for future negotiations, also defines the scope of the investments. The specific interest that leads to the choice of the investment is then defined, having been assessed by the intermediary, and only then is the transaction carried out.

The framework contract and the investment lie at the two extremes of this complex sequence: the first, as a point of emergence of the generic interest, and the second, the moment when the specific interest is made concrete. The order lies midway between the two.

Clearly, the investment order may well be solicited by the intermediary; very often it is. But it can also be the result of the client's independent initiative. Nevertheless, in both cases, the order is the place where this specific interest is

[32] R. Di Raimo, *Finanza, finanza derivata* n 20 above, 1106.

[33] With reference to the existence of disclosure obligations, even if only for execution of orders, see n 19 above.

first clearly formulated.

The difference between the two hypotheses is that in the first it is presumed that, at the moment when the investment is proposed, the intermediary simultaneously fulfils the obligation to provide information relating to the characteristics of the financial instrument, including its degree of riskiness. The proposal therefore contains, in itself, an assessment in terms of suitability or appropriateness of the type of service provided. In the second, on the other hand, fulfilment comes next, with the order representing the act whereby the legally imposed rules of conduct become binding.

The order, therefore, represents the circumstance wherein the specific interest of the customer is defined and the choice of the concrete investment to be made comes about.[34] Compliance with the rules of conduct may be placed upstream of this, if it follows the intermediary's request, or downstream, if it is the result of an independent initiative by the client. However, its significance remains unchanged with regard to assessing the conduct of intermediaries, considering that violation, should the intermediary nonetheless carry out the operation, is in any case a symptom of mismanagement of others' interests.

In terms of remedies, therefore, adopting a procedural perspective, which implies reconstructing the events in terms of a sequence of functionally connected acts by virtue of the ultimate purpose, namely investment, could perhaps lead to solutions other than those offered by the ruling in question.[35] Nevertheless, annulment of the order does not seem to be precluded in any way – at least not according to the interpretations found in the greater part of legal scholarship.[36]

One of the main objections to the solution adopted in case law was, first and foremost, the timing of the obligation to obtain information in relation to the order. Whether the order is interpreted as a contractual offer to sell or a mandate, in either case its performance would be instrumental to the formation of an informed agreement. This is consistent with the logic underlying the EU rules governing individual contractual agreements, where information is seen as the very means by which the position of the parties is balanced in order to avoid market failures. This view, though undoubtedly well established, is subject to many criticisms.[37] Nevertheless, it continues to arise, even in the latest financial

[34] A function that is clouded by considering the order in terms of proposal for the purchase or sale of the financial instrument. The reference to exchange as a function underlying the order does not in fact give due weight to the function performed by the intermediary as guardian of the client's interest, nor does it fully express the functional specificities of the transaction. In particular, from the functional point of view, the contract of sale expresses an exchange of utility; utilities in the asset bought and sold, and their relative objects in the price. In the contract to be concluded upon acceptance of the order, however, the function is not an exchange: it is first of all a brokerage function, given that the purchase of the final utility on which the customer's interest is based is necessarily mediated by the cooperation of the intermediary.

[35] On this point, see section seven below.

[36] Se n 10 and n 12 above for some bibliographical references.

[37] F. Denozza, *I conflitti di interesse nei mercati finanziari e il risparmiatore "imprenditore*

markets reform.[38]

Once the agency of the intermediary, in objective terms, becomes central to the economic transaction, the precise timing of the obligation to inform seems to lose importance compared with the order. It is true that the obligation to obtain information may precede the intermediary's acceptance of the engagement. However, it is also true that a breach may primarily, and at a functional level, represent a flaw in the subsequent act of investment should this not correspond to the client's interest. This interest can be clearly indicated by means of objective indices (such as investment knowledge, willingness to take risks, and the size of the assets), which the work of the intermediary must safeguard, as established in Art 21 TUF.

In other words, regardless of whether the order is situated upstream or downstream of the rules of conduct imposed on the intermediary, carrying out an unsuitable transaction violating the obligations mentioned above reveals a functional defect in terms of safeguarding the client's interest. This results in non-compliance with the more general duty of care, of which the others represent only specific aspects.[39]

VII. The Ineffectiveness of an Investment in Relation to the Client's Legal Sphere

We have said that looking at the problem in procedural terms can open the way to different solutions that, by emphasising the function attributed to the intermediary, fully express the flaw that leads to the execution of an order in violation of the rules of conduct established to protect the client's interests in terms of the sequence of the acts.

Only little needs to be said on this, starting with a clarification. It is clear that this way of looking at the question of the breach of the obligation to obtain information in itself is not the issue, although it can clearly be at least indicative of the aforementioned functional flaw. What is most noticeable is the mismatch between investment and customer interest.[40] This is an interest that, beyond the specific choice indicated in the order, must be identified for the purposes of the subsequent objective assessment to be carried out by the intermediary in the light of specific parameters. These parameters are, in fact, the very object of the

di se stesso", in F. Denozza et al eds, *I servizi del mercato finanziario. In ricordo di Gerardo Santini* (Milano: Giuffrè, 2009), 141; Id, 'Mercato, razionalità degli agenti e disciplina dei contratti' *Osservatorio di diritto commerciale*, 1 (2012), 5-40; Id, 'La frammentazione del soggetto nel pensiero giuridico tardo liberale' *Rivista del diritto commerciale e del diritto generale delle obbligazioni*, 13 (2014); F. Sartori, *Informazione economica e responsabilità civile* (Padova: CEDAM, 2011).

[38] For some points for reflection, see M. Semeraro, *Rischio di impresa bancaria* n 28 above, 866.

[39] From a slightly different perspective, M. Lobuono, n 16 above, 144.

[40] R. Di Raimo, *Finanza, finanza derivata* n 20 above, 1106.

so-called passive obligations to obtain information incumbent on the intermediary. Therefore, as far as the fate of the investment is concerned, the first decisive factor is the suitability or appropriateness test.

This seems to reflect a passage in the ruling in question, where it clearly distinguishes between violation of the rules of conduct and the outcome of the investment, concluding that the latter

> 'shows solely, as a measure of the interest that the investor, as a non-defaulting contracting party, may have in relation to the expiry of one (or more) of the orders made'.

The fate of an investment essentially depends on the extent to which the transaction corresponds to the client's objective interest, rather than its outcome in economic terms. Following the procedural approach, the unsuitability or the inappropriateness of the investment therefore causes a fracture in the sequence of phases. In particular, they lead to a fracture between the framework contract and the subsequent execution of the order.

Above all, the framework contract constitutes the point at which the client's general interest becomes explicit, and the order is when the specific interest emerges, ie, his or her interest with regard to a specific investment. The transition from general interest to specific interest is governed by the provisions contained in Art 21 TUF, which requires the intermediary to take the best possible care of the client's interests. The intermediary engaged to execute the order is therefore responsible for assessing it on the basis of specific objective parameters: the client's investment knowledge and risk profile, as already mentioned. It is only if the choice is consistent with these parameters that the execution of the order is justified, and therefore the investment itself.

As has been emphasised,[41] of particular relevance is the large gap between the figure of the intermediary and the client. The task of attributing the assessment of the suitability of the specific choice to the intermediary is clearly justified in view of the particular importance of the interest in the investment enshrined in the principle of safeguarding savings under Art 47 of the Italian Constitution.[42]

If the assessment of the suitability of the choice is left to the intermediary in accordance with Art 21 TUF, executing an investment not justified by specific financial knowledge or experience or a specific risk appetite together with a certain level of equity can only represent an imbalance in power.[43] From the point of

[41] See section five.

[42] For some methodological observations, see P. Perlingieri, n 27 above, 326. On the constitutional basis of the negotiating power of the intermediary, see especially R. Di Raimo, *Finanza, finanza derivata* n 20 above.

[43] Resorting to ineffectiveness implies overcoming, in terms of remedy, the distinction between abuse and excess; in this regard, see the clear exposition by R. Di Raimo, *Fisiologia e patologia dei rapporti* n 20 above, 66, who successfully achieves this by interpreting the intermediary's position in terms of a private law function.

view of remedy, this can only lead to the ineffectiveness of the investment with respect to the client's legal sphere.[44]

[44] However, R. Lener and P. Lucantoni, 'Regole di condotta nella negoziazione degli strumenti finanziari complessi: *disclosure* in merito agli elementi strutturali o sterilizzazione, sul piano funzionale, del rischio come elemento tipologico e/o normativo?' *Banca, borsa, titoli di credito*, 369 (2012), who envisage only compensation as a remedy for the violation of suitability rules.