

**Closing out equity options: The
recent Commercial
Court decision in Euroption v SEB**

Daniel Toledano QC

One Essex Court Chambers

Euoption v SEB

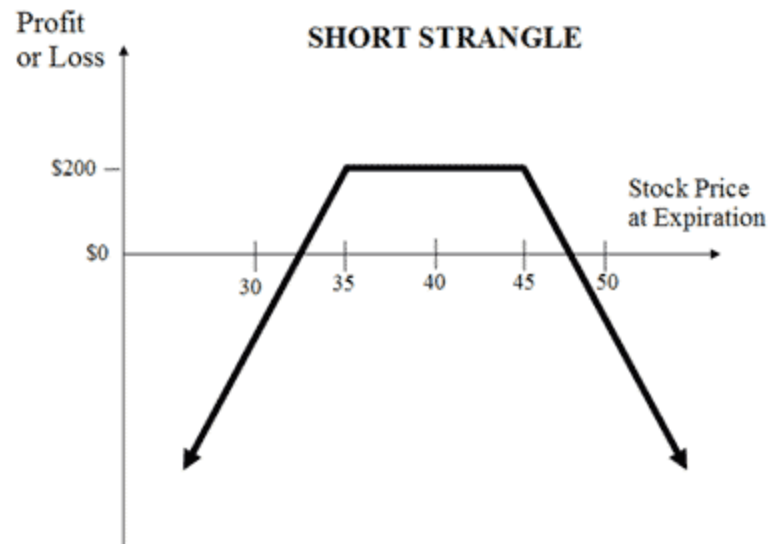
- Dame Elizabeth Gloster DBE
- Commercial Court
- Judgment dated 15 March 2012

Euroption v SEB: Facts

The Fund

- Euroption was a BVI investment fund
- It was an options trader
- The options related to European share indices
- Its principal trading strategy was the **short strangle**, a combination of put and call options

The Short Strangle



Euroption v SEB: Facts

SEB as clearing broker

- SEB is a Swedish investment Bank
- SEB acted as Euroption's clearing broker
- A clearing broker is needed because the options are traded on an exchange
- Settlement takes place through a Clearing House
- The Clearing House demands margin which SEB demands from Euroption

Euoption v SEB: Facts

Week of 6 October 2008

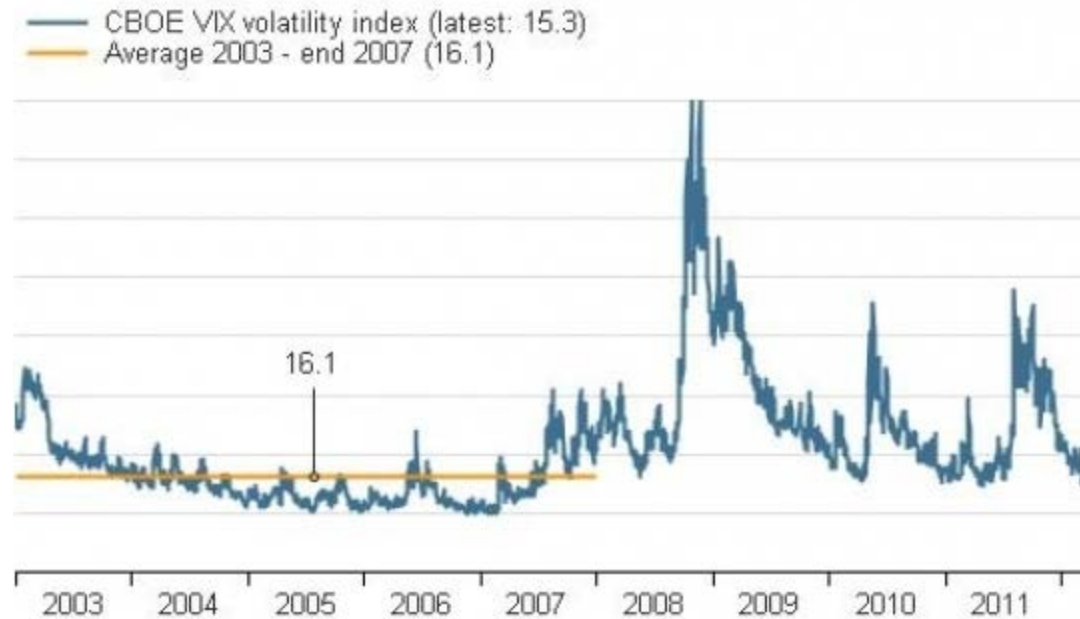
- Week of 6 October 2008 one of worst in history of financial markets
- Dramatic falls in shares around the world
- Volatility at records highs

FTSE 100 October 2008 Crash



VIX Volatility Index

VIX volatility index



Source: Thomson Reuters Datastream

Reuters graphic/Scott Barber 3

Euroption v SEB: Facts

Margin default and Close-out

- Euroption did not meet margin calls of up to €57m.
- SEB was entitled to close out Euroption's open positions.
- SEB closed out Euroption's positions leaving a positive ledger balance of €2m

Euroption v SEB: Facts Proceedings

- Euroption commenced proceedings against SEB.
- Negligent conduct of close-out alleged
- Alleged loss of €36m minus the €2m returned to the Fund
- Loss of investment opportunity also alleged making total claim of €135m

Euoption v SEB: Mandate Clause 11

The Client is warned that, if at any time it has failed to provide sufficient margin or other payment or delivery due in respect of any transaction as required, SEB shall be entitled to close out the Client's open contracts at any time without reference to the Client.

Furthermore, it is an FSA requirement that where clients' margin calls are not met within five business days, all positions must be closed out. Any sum due to SEB as a result of closing out those contracts will be payable by the Client to SEB immediately.

Euoption v SEB: Mandate

- How should SEB exercise its rights under clause 11 of the Mandate?
 - Answer 1: SEB may exercise its rights in whatever way it chooses and can come under no liability
 - Answer 2: SEB must act in good faith and rationally
 - Answer 3: SEB must act reasonably in accordance with a duty of care to its client

Paragon v Nash (2001)

- Decision of the Court of Appeal
- Lender had right to vary interest rate payable
- Held: implied term that rate of interest would not be set dishonestly, for an improper purpose, capriciously or arbitrarily
- No implied term that lender would not impose unreasonable rates

Socimer v Standard (2008)

- Decision of the Court of Appeal
- Application of the Paragon v Nash implied term in a default context
- Trading between banks in emerging market securities
- Exercise of right to value portfolio following default
- No duty to take reasonable care to determine true market value, just need for honest but otherwise subjective valuation

Fluxo-Cane (2010)

- Group of 3 cases decided in 2010
- Decisions of David Steel J and Blair J
- Liquidation of sugar positions by brokers
- Held: brokers not liable, but was the court suggesting that a duty to take reasonable care in the liquidation existed?

Euromotion v SEB (2012)

- Gloster J applied the Socimer approach
- SEB required to exercise its right to close out positions in good faith and rationally, but did not owe a duty in contract or tort to carry out the close-out with reasonable skill and care

Damages for Loss of investment opportunity

- Recoverable for deceit: **Parabolla Investments v Browallia**
- One difficulty in negligence actions is that pure economic loss is not normally recoverable
- What about contract claims? Would such losses be too remote?
- No answer in Euroption v SEB, but considerable scepticism

Euoption v SEB: Conclusion

- Considerable measure of discretion afforded to decision makers in default context
- Court does not interfere with decision taken in good faith and rationally
- Loss of investment opportunity claims not ruled out but remoteness likely to be an issue