The Effects of the Global Financial Crisis on the Binding Force of Contracts: A Focus on Disputes over Structured Notes in Taiwan

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Chapter 16
The Effects of the Global Financial Crisis on the Binding Force of Contracts: A Focus on Disputes over Structured Notes in Taiwan

Chang-hsien Tsai

Abstract  Taiwan, whose financial market is closely linked to the international market, was seriously affected by the Global Financial Crisis. Among the affected retail investors, those who invested in financial products such as structured notes might have been unaware of the real risk these products posed. Investors left holding worthless products in the wake of the 2008 crash were quick to seek legal redress for their losses, but these disputes were difficult to address by properly using the civil remedies then available in Taiwan. Few of the possible causes of actions listed in the Taiwanese Civil Code (“CC”) or in other special laws were well adapted to address disputes over structured notes. The most applicable remedy available in the then legislation might be Article 227-2 of the CC, which governs the rule of changed circumstances, but it was referred to only rarely in these disputes. In order to put an end to this type of structured-note controversy, the Financial Consumer Protect Act (“FCPA”) was passed in 2011. Nevertheless, there is room for the FCPA to be improved and refined.

16.1 Introduction

In 2008, an economic crisis struck most of the world’s financial markets (Wang 2011b, 1945). During the Global Financial Crisis (“GFC”), markets were devastated by bank over-lending, and consequently several international financial companies were unable to sustain their business, sparking serious controversy around the international financial market.

Taiwan, whose financial market is closely linked to the international market, was also seriously affected by this disaster. Among affected retail investors, those who invested in financial products such as structured notes might have been unaware of
the real risk they ran in doing so.\(^1\) This has resulted in a multitude of disputes that proved difficult to properly address through the civil remedies then available in Taiwan. Although authorities found temporary solutions for the problem, the need for a special act exclusively protecting financial consumers was evident, finally leading to the passing of the Financial Consumer Protection Act (“FCPA”) in 2011.

An overview of the problem with structured notes in Taiwan will be presented in this chapter as follows: Sect. 16.2 will deal with the question of whether the rule of changed circumstances is applicable in circumstances such as financial crises; in Sect. 16.3, the development of legislation following the GFC will be explained; and Sect. 16.4 will conclude this chapter with a brief assessment of the FCPA’s prospects.

### 16.2 The Principle of Pacta Sunt Servenda v. Clausula Rebus Sic Stantibus

#### 16.2.1 A Summary of Theories

If the effects of the GFC on contracts are taken into consideration in Taiwan, the theoretical basis appears to lie in the rule of a fundamental change of circumstances (*clausula rebus sic stantibus*), or the idea of frustration of contracts.

The first issue affected by the GFC that will be explored herein is the “rule of changed circumstances,” which concerns sudden events that affect the foundation of transactions. In the GFC context, the question is whether those structured note contracts can be terminated or rescinded, as some retail investors claim, because in some instances the GFC totally changed the circumstances at the moment a contract was signed.

In terms of law, the rule of changed circumstances is an exception to the principle of *pacta sunt servenda* (“the promise must be kept”). The rule of changed circumstances developed under both common law and civil law; in practice, it is often applied to dramatic changes resulting from wars (Hou 2003, 108).

In common law countries, there are two main categories of rules governing situations when an event happens after a contract is formed. The first category consists of contracts that are impractical or impossible to enforce; the second category covers frustration of purposes (Lo 2013a, 70). The idea of changed circumstances was created for and applied in German civil law cases (Peng 1984, 161, 175, 179, 190); it also exists in the Taiwanese Civil Code (“CC”), although with somewhat different wording. In Sect. 16.2.2, the relevant articles in the CC will be introduced.

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\(^1\) Structured notes are hybrid financial products combining derivatives and debts securities, which link to other investment products in the market (see Chen 2011a, 211).
16.2.2 **Principles in the Taiwanese Civil Code**

Some provisions of the CC share certain characteristics of the rule of changed circumstances. Even before the codification of the Taiwanese version of this rule, similar concepts were present in other laws and court decisions. As for the CC, there are two main groups of articles addressing contract enforcement issues under changed circumstances: the first group concerns events that render a contract impractical or impossible to enforce, while the second group addresses other changed circumstances after a contract is formed.

16.2.2.1 **Impracticability or Impossibility**

The first group of articles consists of Article (Art.) 225 and Art. 266 of the CC. These cover objective impracticability or impossibility of enforcement resulting from events that cannot be attributed to any of the parties to a contract. In other words, the consequences of objective impracticability or impossibility cannot be imputed to the debtors. According to these articles, when an event occurs after a contract is formed that cannot be attributed to any of the parties to the said contract, the question of distribution of risks must then be considered. Art. 225 releases the debtor from the obligation of performance if the change cannot be attributed to him or her. Art. 266 releases the creditor from the obligation of counter-prestation when the event cannot be attributed to either party (Chen 2011b, 148).

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2Art. 225 stipulates:

(1) The debtor will be released from his obligation to perform if the performance becomes impossible by reason of a circumstance to which he is not imputed. (2) If the debtor is entitled to claim compensation for the injury against a third party in consequence of the impossibility of the performance under the preceding paragraph, the creditor may claim against the debtor for the transfer of the claim for the injury, or for the delivery of the compensation he has received.

Please note that all English translations of legal texts in this chapter are official translations from the “Law and Regulation Database of the Republic of China” maintained by the Ministry of Justice in Taiwan.

3Art. 266 stipulates:

(1) If none of the parties is imputed to the impossibility of one party’s performance, the other party shall be released from his obligation to perform the counter-prestation. (2) If the impossibility is only partial, the counter-prestation shall be reduced proportionately. In the case provided in the preceding paragraph, if the counter-prestation has been wholly or partially performed, it may be claimed for the reimbursement in accordance with the provisions concerning Unjust Enrichment.
16.2.2.2 The Rule of Changed Circumstances: Background

Art. 227-2\textsuperscript{4} of the CC can be said to be equivalent to the rule of changed circumstances, although its legal or theoretical foundation is somewhat different from common law rules. The CC generally follows the approach of civil law and is patterned mainly after the German Civil Code. Prior to the codification of Art. 227-2, there were even similar developmental backgrounds between Taiwan’s and Germany’s laws regarding changed circumstances. The need to address this issue was highlighted by the problems with enforcing contracts during and after a time of war,\textsuperscript{5} when local market conditions tend to be extremely unstable (Hou 2003, 108).

Although the rule of changed circumstances was not directly imported from Western legal systems, Taiwanese courts have long relied on the principle of good faith to resolve contract disputes due to changed circumstances, which shares the same basis as its development in other civil law countries (Lin 2000, 61). In Taiwan, the idea of changed circumstances was usually cited by courts to deal with dramatic changes in price level indexes and the change of currency after the Second World War (“WWII”) (Hou 2003, 108–110).\textsuperscript{6} The first attempt to codify the rule of changed circumstances was Art. 397 of the Code of Civil Procedure (“CCP”),\textsuperscript{7} which is worded similarly to the current Art. 227-2 of the CC. The former additionally emphasizes that the event is not the result of the actions of either party (Lin 2000, 66–67). This article was initially placed in the CCP rather than the CC in 1968 simply for the sake of expediency.\textsuperscript{8} Before the rule was codified in the CC, courts kept trying to apply similar concepts to this rule based on previous court decisions, such as the interpretation of the principle of good faith and Art. 397 of the CCP (Lo 2013b, 69).

\textsuperscript{4}The full text of and conditions that apply to this article will be discussed in Sect. 16.2.2.3.

\textsuperscript{5}The current ROC government moved to Taiwan after the end of WWII due to the defeat by the Chinese Communist Party in a civil war. Therefore, cases relating to contract enforcement during a time of social change were often brought to the court during and after the war (see Hou 2003, 108).

\textsuperscript{6}Taiwan’s currency changed once after the end of WWII in an effort to control inflation. Most of the court cases related to this event dealt with the value difference between the New Taiwan Dollar and the original Taiwan Dollar.

\textsuperscript{7}Art. 397 used to stipulate:

(1) The court shall, \textit{ex officio}, make just determination and give judgment to increase, decrease, or make payment, or change other effect of any juristic act which has its effect become unjust after it is done due to change of circumstances upon cause not attributable to the parties concerned and beyond their expectation. (2) The above provision shall apply \textit{mutatis mutandis} to legal relationship originated from non-juristic act.

Please note that this article was later modified in February 2003, and now no longer covers changed circumstances in terms of substantive law (as opposed to procedural law).

\textsuperscript{8}The amendment was made in February 1968, when there was no official plan to amend the CC, so that the rule of changed circumstances was placed under the CCP as a temporary solution (see Lin 2000, 66).
Art. 227-2, an official legal basis for the rule of changed circumstances, was finally added in 1999 when the CC was amended (Lo 2013b, 69). This is now the legal foundation for applying the rule of changed circumstances under the CC, as will be discussed in detail in the next section.

16.2.2.3 The Rule of Changed Circumstances: The Conditions Necessary to Accept an Exceptional Outcome

Art. 227-2 of the CC states:

(1) If there is change of circumstances which is not predictable then after the constitution of the contract, and if the performance of the original obligation arising therefrom will become obviously unfair, the party may apply to the court for increasing or reducing his payment, or altering the original obligation. (2) The provision in the preceding paragraph shall apply mutatis mutandis to the obligation not arising from the contract.

However, even after the enactment of this article, the requirements for applying the rule of changed circumstances did not become fully clear, and continued to be supplemented by legal theories and court decisions. Legal scholarship and practice evolved a set of elements to justify the existence of changed circumstances:

- If there is a fundamental change of circumstances, these circumstances must be closely related to the establishment of the contract, and should be an objective event that cannot be attributed to any of the parties. According to the wording of the article, the change need not be sudden or extreme; however, commentators have noted that, referring back to German Law, the change must be substantial (Lo 2013b, 70).
- The event must happen after the contract is formed but before the obligations detailed therein are performed (Lo 2013b, 70).
- The event must have been unforeseeable at the time the contract was formed, which is an important element. This rule applies even if it was unforeseeable only to the claimant. However, commentators and court decisions have recognized that, at least in such cases as a sudden increase of the general price level—even if there are contract terms specifying the price level—the rule of changed circumstances still applies, as the scope of the increase is obviously beyond one’s expectations (Lo 2013b, 70–71).
- The change of circumstances should not result from any fault of the contracting party applying the rule. This requirement can be found in the legislative comments on Art. 227-2.9 It is worth discussing further the question of whether, aside from force majeure events, the rule applies to those events due to the fault of a third party. Some commentators believe it still applies when there are no other possible remedies (Lo 2013b, 71–72).
- The change of circumstances has led to an obviously unfair situation: If the result is so unjust that no one can expect the affected party to continue to abide

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9See the Legislative Comment on Art. 227-2.
by the terms of the contract, then the contract cannot be considered binding (Lo 2013b, 72).

With those elements in the CC, the question is therefore whether the events of the GFC qualify as exceptional circumstances. If so, we must then discuss whether this rule has legal applications that retail investors can take advantage of.

16.2.2.4 Exceptional Circumstances that Justify an Intervention Due to Changed Circumstances Under the Taiwanese Civil Code

As stated above, concepts similar to the rule of changed circumstances had already been invoked by courts before the rule was codified in the CC. These court decisions made before codification are important references for interpreting the current Art. 227-2 (Lo 2013b, 74). In the context of financial crises, the core issues requiring interpretation seem to be the standard of “obviously unfair” and foreseeability.

The standard of “obviously unfair” The wording of Art. 227-2 itself provides no clue as to how to decide what constitutes “obviously unfair.” There are two cases that may serve as particularly clear demonstrations of the problem: both share a similar factual background, but came to different conclusions.

In 2009 the Taiwan Supreme Court ruled that if the contractor is not economically disadvantaged, and if there is a price-index-adjustment term included in the contract, the rise of the price index is insufficient justification for invoking the rule of changed circumstances. Nonetheless, the Supreme Court also held that when a significant rise in price would lead to unfair results if the contract remained in force, then the rule of changed circumstances could be invoked and the contract terms adjusted. In this case the Supreme Court applied the rule without additional requirements such as weighing the economic strength of the contracting parties. Although the two cases seem to contradict one another, the concept of “substantive fairness” is common to both.

Foreseeability An unforeseeable event is another condition that might necessitate invoking the rule of changed circumstances. One example of this can be found in another 2009 case, where the court, in a previous decision, determined that the worsening of marine conditions was not unforeseeable because the contractor knew that the construction site was in a sub-tropical marine area and the weather was unstable; therefore she could not invoke the rule of changed circumstances (Lo 2013b, 75).

Further examples of the standard of determining foreseeability can be found in previous cases addressing price level changes. In these typical cases, the courts determined that if the price level term has been included in a contract, the rule of

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10 Zuigao Fayuan [Sup. Ct.], Civil Division, Tai-Shang No. 2470 (2009) (Taiwan).
11 Zuigao Fayuan [Sup. Ct.], Civil Division, Tai-Shang No. 2299 (2009) (Taiwan).
changed circumstances is generally not applicable (Cheng 2010, 11–12) unless the result of a change is unconscionable. Based on these court decisions, the interpretation of terms in a contract involving financial products such as structured notes might be an important key to the issue of whether the investment or credit risk thereof is unforeseen.

However, even if the rule of changed circumstances can be applied in controversies resulting from the GFC, whether the legal effects of this rule meet the needs of retail investors is another question, one that will be explored in the next section.

16.2.2.5 The Legal Consequences of the Rule of Changed Circumstances

According to Art. 227-2, the legal consequences of applying the rule of changed circumstances appear to be clear, including “increasing or reducing his payment” and “altering the original obligation.”

Nevertheless, theoretically there are two tiers of possible legal consequences of applying the rule of changed circumstances. The primary consequence is to allow the court to adjust the contract terms while maintaining its validity. If the adjustment cannot offer a fair result, secondary consequences come into play (i.e., termination or rescission of a contract), which must be decided by the court (Hou 2003, 114).

According to past court practices, civil courts in Taiwan decided contract adjustment in cases involving a change of a currency value (Hou 2003, 115). In these cases, the Supreme Court stated that the advantages and disadvantages faced by both parties because of the change of circumstances should be taken into consideration in order to reach a fair adjustment (Hou 2003, 115). Other possible means of adjusting contracts include delaying the deadline, changing the type of payments, or invoking Art. 265 of the CC (Hou 2003, 114).

Only if the adjustment fails to achieve a fair result, as commentators assert, may the court decide to terminate or rescind the contract, and award damages if necessary, based on the principle of good faith (Lin 1963, 20). This two-tier approach is

12 See also the following similar court decisions: Zuigao Fayuan [Sup. Ct.], Civil Division, Tai-Shang No. 760 (1995) (Taiwan); Gaodeng Fayuan [High Ct.], Civil Division, Jian-Shang No. 126 (2007) (Taiwan); Gaodeng Fayuan [High Ct.], Civil Division, Jian-Shang No. 99 (2007) (Taiwan); Gaodeng Fayuan [High Ct.], Civil Division, Jian-Shang-Geng (Yi) No. 32 (2009); Gaodeng Fayuan [High Ct.], Civil Division, Jian-Shang No. 59 (2009) (Taiwan).

13 See Gaodeng Fayuan [High Ct.], Civil Division, Jian-Shang No. 53 (2008) (Taiwan).

14 See also the following court decisions supporting this ruling: Zuigao Fayuan [Sup. Ct.], Civil Division, Tai-Shang No. 1771 (1958) (Taiwan); Zuigao Fayuan [Sup. Ct.], Civil Division, Tai-Shang No. 2630 (1997) (Taiwan).

15 Art. 265 states:

A person who is bound to perform his part first may, if after the constitution of the contract the property of the other party have obviously decreased whereby the counter-prestation might become difficult to be performed, refuse to perform his part, until the other party has performed his part or furnished security for such performance.
meant to maintain the validity of a contract as long as possible, as, in accordance with the principles of the CC, the court should not interfere in private transactions unless absolutely necessary (Lo 2013b, 75).

However, secondary consequences have yet to be applied in court decisions, so opinion has it that only “adjustment”—the primary consequence—is allowed by the CC (Hou 2003, 114). As one commentator reckons, the only choice provided in Art. 227-2 and the former text of Art. 397 in the CCP is “adjustment,” and it is possible that Taiwanese courts have never tried to broaden this interpretation to cover the secondary consequences of the rule (Hou 2003, 115).

It is thus possible to make a temporary argument regarding application of the rule of changed circumstances to a dispute over structured notes: According to the current text of Art. 227-2, it is important to assess the interpretation of an investment or credit risk if the rule of changed circumstances can be applied in the context of the GFC. Even if the rule does apply, the wording of Art. 227-2 and previous court decisions imply that the court may only adjust the payment. It is also necessary for retail investors who took part in transactions involving structured notes to apply to the court in order to benefit from this remedy (Huang 2005, 22–23).

The typical issues involved in disputes over structured notes in Taiwan and the legal tools available to address these disputes will be introduced in the next section.

### 16.3 The Effects of the Global Financial Crisis on the Binding Force of Contracts in Taiwan: Renegotiation, Rescission, or Revision?

#### 16.3.1 The Effects of the Global Financial Crisis on the Binding Force of Contracts in Taiwan: Lessons from Disputes Over Structured Notes

#### 16.3.1.1 Background

Financial institutions in Taiwan began promoting structured notes around 2001; before this time, investors had to purchase these financial products through foreign banks (Lin 2012, 82). In 2003, the Ministry of Finance (“MOF”) announced regulations on disclosing information related to investment-linked insurance policies in order to protect retail investors. In September 2008, Lehman Brothers Holdings Inc. (“Lehman Bros.”) went bankrupt, and all transactions involving structured notes issued or brokered by Lehman Bros. were suspended during the period of bankruptcy protection (Lin 2009, 45). This event set off a wave of lawsuits brought against banks; retail investors argued that the banks’ sales representatives had not fully disclosed the risks inherent in purchasing structured notes (Lin 2009, 46).
16.3.1.2 Typical Controversies

At the core of the controversies outlined above is what is known as a “Designated Money Trust” (“DMT”), a kind of contract used by banks to sell structured notes to retail investors (Li 2009, 29). Under DMT contracts, investors (clients) retain the right to decide how to use their money, while banks are required to offer financial products that entail a risk level appropriate for each client and to disclose investment risks (Li 2009, 29).

In cases where a dispute over structured notes enters into renegotiation procedures or the parties of a DMT contract go to court, the most common type of disputes was the charge that the client lacked information for one reason or another—that the retail investor lacked the necessary knowledge to understand the financial products he or she was offered, that the bank did not fully disclose the necessary information, or that the information was not given at a proper time (Ku 2010, 119). Another frequent cause of disputes was whether banks (or their salespersons) had adequately discharged their fiduciary duties (Ku 2010, 120). Ku (2010) compiled a list of the most common types of disputes (Table 16.1).

16.3.1.3 Temporary Solutions

Before the FCPA was passed, there was no professional authority to handle these kinds of disputes over financial products. The provisional authority in charge was the Bank Bureau of the Financial Supervisory Commission (“FSC”), tasked with resolving cases in which the disputed value was larger than one million New Taiwan Dollars (“NTD”). Other cases involving objects under one million NTD were

Table 16.1 The most common types of structured-note disputes (Ku 2010, 119)

<table>
<thead>
<tr>
<th>Types</th>
<th>Facts</th>
<th>Legal claims made by investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Retail investors lacked necessary knowledge; some of the investment documents were filled out or signed by bank salespersons</td>
<td>The contract was obviously unfair and should be invalid</td>
</tr>
<tr>
<td>2.</td>
<td>Banks did not go through the “Know Your Customer” (“KYC”) process, or did not recommend suitable products according to the risk-bearing levels of respective clients</td>
<td>1. Applying Art. 184 of the CC: Banks violated some statutory provisions enacted for the protection of others, so that it is an act of tort 2. Banks did not fulfill their duty of care as prudent administrators</td>
</tr>
<tr>
<td>3.</td>
<td>Banks promoted structured notes as a kind of fixed-income deposits</td>
<td>The contract was formed due to fraud or a mistake</td>
</tr>
<tr>
<td>4.</td>
<td>Banks did not disclose that the contract would include a service fee</td>
<td>The contract was based on fraud</td>
</tr>
<tr>
<td>5.</td>
<td>A full set of documents was not given to retail investors</td>
<td>The contract was not yet constituted</td>
</tr>
<tr>
<td>6.</td>
<td>Banks did not provide an alert to price or risk changes at a proper time</td>
<td>Banks did not fulfill their fiduciary duties</td>
</tr>
</tbody>
</table>
handled by either the Securities and Futures Investors Protection Center ("SFIPC") if a Lehman Bros. product was involved, or the Bankers Association of the ROC ("BAROC") if non-Lehman Bros. structured notes were involved. All of the above cases that passed procedural review were finally assigned to the Appraisal Committee of Financial Consumer Disputes under the BAROC ("Appraisal Committee") for substantive review (Wang 2011b, 1980). The temporary mechanism is summarized in Fig. 16.1 below.

However, some cases involving structured notes did not fit the legal definition of "consumer disputes" in the Consumer Protection Act ("CPA"), and therefore do not fall under the BAROC’s jurisdiction. In response to public pressure, the BAROC solved the problem by amending its own administrative rules to include any cases referred to it via the appropriate authorities (Wang 2011b, 1980).

As of April 1, 2011, 25,214 cases had been reviewed under this provisional system; however, only the first 100 decisions made by the Appraisal Committee were open to the public for reference at that time (Chen 2011a, 211). Therefore, the general public was not in a position to acquire information about the provisional Alternative Dispute Resolution ("ADR") procedures mentioned above. Furthermore, adjudications made by the Appraisal Committee had no binding force on individual complainants when neither party had agreed to the settlement terms; decisions were only binding on banks under certain conditions (Chen 2011a, 212; Li 2009, 37). At the same time, in order to maintain its neutral position, the Bank Bureau itself could not make any decision on an individual case unless the bank in question had been proved to have violated the law. Thus, in this regard, the BAROC was the actual authority operating the temporary ADR mechanism (Kuo 2012, 52–61).

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**Fig. 16.1** The Pre-FCPA temporary dispute settlement mechanism (Lin 2009, 46)
16.3.1.4 Obstacles to Applying Available Remedies

Even if a temporary mechanism cobbled together in a hurry was available, the uncertainty over what constitutes a valid cause of action was still problematic. Applicable remedies were still scattered among various statutory provisions, and therefore it was difficult for retail investors to identify sufficient and effective remedies (Tsai 2013, 14–17). Theoretically, causes of action for retail investors to seek damages or to adjust a contract term involving structured notes might include the following articles (Tsai 2013, 6–7; see also Chen et al. 2012, 57–78):

- Art. 88 and Art. 89 in the CC relate to mistakes in signing contracts. Art. 92 and Art. 93 provide remedies if a contract is fraudulent or was signed under duress; however, it is difficult for retail investors to prove a bank’s mens rea, and these articles provide a limited amount of time for individuals to seek legal redress.
- According to Art. 153 in the CC, an investor may claim that the two parties have not reached an agreement on necessary elements in the contract, and thus the contract has not been finalized.
- Many investors relied on the Trust Law (Art. 22 and Art. 23) and the Trust Enterprise Act (Art. 22, Art. 23, and Art. 35), or the liability rules governing a contract of mandate in the CC (Art. 535 and Art. 544); however, proof is still needed as to what constitutes a bank’s fiduciary duties in selling financial products, or whether a bank salesperson’s breach of company internal rules constitutes a breach of fiduciary duties as provided under the above laws.
- It is also difficult to apply tort law (e.g., Art. 84, Art. 188 and Paragraph 1 of Art. 197 in the CC) because it is difficult to prove a bank’s mens rea.
- Art. 247-1 in the CC controls the content of standard form contracts. Retail investors may claim that the standard form contract was so unfair or so much against good faith that it should be declared unenforceable; however, the court may not agree if the complainant signed the contract, as signing personally is usually taken to mean that one agrees to the contract terms.
- Retail investors claiming that their contracts were not finalized may encounter difficulties when trying to apply Art. 245-1 of the CC. This article covers pre-contractual liabilities in cases where a contract is not finalized, and requires

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16 Art. 247-1 of the CC states:

If a contract has been constituted according to the provisions which were prepared by one of the parties for contracts of the same kind, the agreements which include the following agreements and are obviously unfair under that circumstance are void. (a) To release or to reduce the responsibility of the party who prepared the entries of the contract. (b) To increase the responsibility of the other party. (c) To make the other party waive his right or to restrict the exercise of his right. (d) Other matters gravely disadvantageous to the other party.

17 Art. 245-1 of the CC provides:

(1) Even though the contract is not constituted, one of the parties is responsible for the injury caused to the other party who without his own negligence believed in the constitution of the contract when he, in order to prepare or negotiate for the contract, has done either of
retail investors to prove that financial institutions intentionally concealed or lied about important information before entering into the contract. Nonetheless, once an investor has entered into an agreement with a bank, it is not easy to invoke the article.

- The court has rarely agreed that structured notes are “securities” as defined in the Securities and Exchange Act; however, neither has the court agreed that the Securities Investment Trust and Consulting Act applies, as a transaction that per se would be deemed a DMT contract is not a security.
- Under the current definition in the CPA, structured notes are not “products” and it is therefore impossible for retail investors to invoke the CPA in structured-note-related disputes.
- As discussed in Sect. 16.2.2, Art. 227-2 might theoretically be taken into account to adjust the terms of DMT contracts in structured note cases, but this type of claim is rarely made. This may be due to the strict conditions required by law, which might deter retail investors from applying the rule of changed circumstances in actual cases.

It is obvious that there were no sufficient and effective regulations targeting so unusual a financial product as the structured note. In order to prevent similar problems in the future, the FCPA finally went into effect in 2011.

### 16.3.2 A New Horizon: The Enactment of the Financial Consumer Protection Act

#### 16.3.2.1 Introduction of the Financial Consumer Protection Act

When the FCPA was passed in June 2011, the Taiwanese legislature required that the FSC, as the competent authority of this Act, establish an additional professional authority to handle financial consumer disputes (Lin 2012, 34).

This new Act covers the following subjects:

- The financial services enterprise (Art. 3).\(^\text{18}\) This definition includes the following entities: “banking enterprises, securities enterprises, futures enterprises,

\(^\text{18}\)Art. 3 stipulates:

(1) The term “financial services enterprise” as used in this Act includes banking enterprises, securities enterprises, futures enterprises, insurance enterprises, electronic stored value card enterprises, and enterprises in other financial services as may be publicly announced by the competent authority. (2) The terms “banking enterprises,” “securities enterprises,” “futures
insurance enterprises, electronic stored value card enterprises, and enterprises in other financial services as may be publicly announced by the competent authority” (Chiu et al. 2012, 24).

- Financial consumers. Art. 4 of the FCPA defines financial consumers as “parties that receive financial products or services provided by a financial services enterprise,” but excludes consumers with a certain level of income or with professional knowledge of investment; therefore, investment companies apparently cannot be consumers under the FCPA (Chiu et al. 2012, 25).

- Financial consumer disputes. The FCPA only copes with CC disputes over financial products or services (Art. 5) (Chiu et al. 2012, 26). However, these disputes also include disagreements that arise during contracting or advertising, and other similar disputes between parties that relate to financial products or services (Chiu et al. 2012, 26).

Nevertheless, commentators indicated that this legislation merely provided another new channel for seeking relief; it is not a catchall to cover every issue. Obviously, it is not an ultimate solution for every future dispute similar to those over structured notes (Lin 2011, 27).

### 16.3.2.2 New Causes of Action

The FCPA imposes new obligations on financial service enterprises, particularly regarding new causes of action to be applied in financial consumer disputes. These new obligations include: additional requirements in advertising (Art. 8); KYC and

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19 Art. 4 provides:

(1) The term “financial consumer” as used in this Act means parties that receive financial products or services provided by a financial services enterprise; provided, however, that it does not include the following: 1. qualified institutional investors; or 2. natural persons or juristic persons with a prescribed level of financial capacity or professional expertise. (2) The meanings of the terms ‘qualified institutional investors’ and ‘prescribed level of financial capacity or professional expertise’ as used in the preceding paragraph shall be prescribed by the competent authority.

20 Art. 8 states:

(1) A financial services enterprise, in publishing or broadcasting advertisements or carrying out solicitation or promotional activities, shall not engage in falsehood, deception, concealment, or other conduct sufficient to mislead another party, and shall verify the truthfulness of the content of its advertisements. The obligation it bears to financial consumers shall not
suitability requirements (Art. 9); duties of full explanation and disclosure (Paragraphs 1 and 3 of Art. 10); and exercising the due care of a good administrator and fiduciary duty (Paragraph 3 of Art. 7). The FCPA also specifies that obligations may not be limited or exempted by prior agreement (Art. 6). The above articles emphasize financial institutions’ obligations to be “honest,” to fully disclose information (especially information about risks related to financial products), and to sell suitable products to financial customers (who are usually far less informed about the products they are buying than financial institutions).

To summarize, the FCPA supplies two new causes of action for financial consumers (Wang 2011a): (1) Liabilities for false advertising; and (2) Breach of duties for implementing KYC and the suitability test, as well as the duties of explanation and disclosure. The liability standard is strict liability, as Art. 11 of the FCPA

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21 Art. 9 stipulates:

(1) Before a financial services enterprise enters into a contract with a financial consumer for the provision of financial products or services, it shall fully understand the information pertaining to the financial consumer in order to ascertain the suitability of those products or services to the financial consumer. (2) Regulations governing what “information pertaining to the financial consumer” must be fully understood and what matters relating to “suitability” must be taken into account, as mentioned in the preceding paragraph, and other matters requiring compliance, shall be prescribed by the competent authority.

22 Art. 10 provides:

(1) Before a financial services enterprise enters into a contract with a financial consumer for the provision of financial products or services, it shall fully explain the important aspects of the financial products or services, and of the contract, to the financial consumer, and shall also fully disclose the associated risks… (3) The explanations and disclosures that the financial services enterprise provides to the financial consumer, as mentioned in paragraph 1, shall be in text or use another method that is fully understandable to the financial consumer; and the content thereof shall include, without limitation, aspects of material significance to the interests of the financial consumer, such as transaction costs, and possible gains and risks. Regulations governing related requirements shall be prescribed by the competent authority.

23 Paragraph 3 of Art. 7 states:

A financial services enterprise, in providing financial products or services, shall exercise the due care of a good administrator; for any financial product or service it provides that has the nature of a trust or mandate arrangement, the financial services enterprise shall also bear such fiduciary duty as may be required by applicable legal provisions or contractual stipulations.
requires that a financial services enterprise bear the liability for paying damages to financial consumers if any of the above duties are breached (Wang 2011b, 1986). Placing strict liability on financial services enterprises takes into account their contracting power and the information asymmetry existing between the parties to transactions involving financial services or products. Hence, even if a financial services provider merely plays the role of brokers, it cannot be exempted from liability by claiming that it had insufficient knowledge of the product it provided (Wang 2011b, 1986).

These new causes of action may prove to be more direct and powerful weapons for retail investors to use against financial institutions than the remedies that existed before the FCPA came into effect. Furthermore, the FCPA provides other procedural rules to resolve disputes over this kind of financial transaction, as will be discussed in the next section.

### 16.3.2.3 The Establishment of the Financial Ombudsman Institution

Another important contribution of the FCPA is the establishment of an independent authority that exclusively handles financial controversies: the Financial Ombudsman Institution (“FOI”). The FOI is an answer to previous difficulties where financial consumer disputes were widely dispersed in various courts but not decided under a common guideline, and the pace of courts’ decision-making further compounded the confusion (Tsai 2013, 16).

The FOI is a semi-official foundation funded by both regulated private enterprises and government agencies (Lin 2011, 32). The decision-making organ of dispute resolution is the ombudsman committee (Art. 17 and Art. 18), which is composed of 9–25 members. These members include scholars, experts, and other professionals with sufficient practical knowledge. Because the FOI is merely a semi-official foundation, the FCPA vests the committee with the power to ask financial services enterprises to provide necessary documents (Art. 20).

However, retail investors still have to make a complaint to those financial services enterprises before they are allowed to apply to the ombudsman committee (Art. 24) (Lin 2011, 32). The process of dispute resolution generally goes as follows: after a retail investor brings a complaint to the financial services enterprises concerned, the investor may then file the case with the FOI. The FOI will first review the case to determine whether there is any possibility of reaching a settlement.

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24 Art. 11 stipulates:

A financial services enterprise which, by violating any provision in either of the two preceding articles, causes harm to a financial consumer shall bear liability for damages; provided, however, that this shall not apply if the financial services enterprise can prove that occurrence of the harm was not due to: its failure to fully understand the suitability of a product or service to the financial consumer; its failure to provide an explanation, or provision of an explanation that was untrue or incorrect; or its failure to fully disclose risks.

25 Id.
if not, the ombudsman committee will start the committee hearing procedure. From the moment the case is referred to the FOI, the decision must be made within 3 months (Chiu et al. 2012, 45–46). This system was designed to address disputes in a reasonable and timely manner. The process of dispute resolution is outlined in Fig. 16.2 below.

Nevertheless, some problems remain with the design of the current system. The first issue is the protection of a retail investor’s right to choose from various dispute-resolution civil procedures. The FCPA leaves room for the two parties to agree freely on whether to be bound by the committee’s decision. The FCPA also devised

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Fig. 16.2 Flowchart of dispute resolution after the establishment of the FOI (Lian 2013, 95)
an “agreement in advance” mechanism: if a financial institution agrees to enter into dispute resolution procedures under the FCPA, either through a written statement before entering into the procedures or in a contract involving the disputed financial products or services, the financial institution will automatically be bound by the ombudsman committee’s decision in cases where the value of the disputed products or services is under a certain amount (Lian 2013, 108). However, in cases where there is no agreement in advance or the value of the disputed products or services exceeds “a certain amount,” the financial institution retains the final say on whether or not it will be bound by the FOI’s decision. This is unfair to retail investors with weaker bargaining power (Lin 2011, 36; Kuo 2012, 77).

Second, members of the ombudsman committee make decisions by casting votes; this process makes the composition of the committee a crucial variable. The time needed to review a case could be prolonged, as the committee members do not work full-time. However, it is required by law that a committee consist of a wide range of professionals “borrowed” from outside institutions, and therefore full-time committee members may be an option for reform in the future (Lin 2011, 38–39). In order to maintain fairness in their decisions, committee members should be protected from unnecessary liabilities in exercising their authority, which would also require an amendment to the FCPA (Kuo 2012, 79). Neither does the current system offer an internal review mechanism, which might be necessary to maintain the fairness and coherency of the FOI’s decisions (Kuo 2012, 79).

Third, the authority of the committee is also important. As it stands, the FCPA does not impose a real duty on financial services enterprises to cooperate with the committee, such as to provide necessary documents. Art. 20, for example, allows the committee to ask financial institutions to provide necessary documents, but it does not grant the committee the power to impose punishment for a failure to cooperate, thus further weakening the committee’s authority. Therefore, penalties for non-compliance need to be clearly codified in the FCPA in the future (Lin 2011, 39).

Furthermore, based on the limited range of subjects covered in the FCPA, it appears that different authorities continue to regulate other relevant financial products or services. For example, in one court case involving investment-linked insurance policies, the financial product in question was in fact linked to structured notes; however, whether this case could have been reviewed by the FOI under the current provisions of the FCPA is unclear (Wang 2011b, 1989). One commentator indicated that this conundrum substantiates the necessity of integrating the regulation of all financial-consumer-related cases under one law, thus providing full protection to financial consumers as the U.S. Consumer Financial Protection Bureau (“CFPB”) does (Wang 2011b, 1990).

26 Please note that “a certain amount” is determined according to product types. For example, the threshold amount is 1 million NTD for investment-linked products or services, while the amount for non-investment-linked ones is 0.1 million NTD (Financial Supervisory Commission 2012).
16.4 Conclusion

Concepts and Regulations similar to the rule of changed circumstances have long been applied in Taiwan, particularly in efforts to address the changes in the economic environment that have occurred during the second half of the twentieth century, despite the fact that the rule was not officially codified in the CC until 1999. However, the elements of Article 227-2 of the CC still leave it to the courts to establish a fixed and clear standard for applying the rule and to furnish guidance on the possible legal consequences of doing so. Based on previous court practices, it should be possible to apply this rule in financial-crisis-related disputes, but such cases are rare.

Obviously, among the disputes that arose during and after the 2008 GFC, disputes over structured notes deserve special attention, especially due to the bankruptcy of Lehman Bros. These particular disputes illustrate how extremely complicated the financial market is without proper and clear regulation.

The multitude of suits brought in the wake of the GFC illuminated the chaotic state of the legal remedies available to complainants. The CC and other special laws provide a number of possible causes of actions, but few of them are well-suited to address disputes over financial products or services. Although Article 227-2, which governs the rule of changed circumstances, should have been applied as a remedy, it was rarely referred to in such cases. This may be because the requirements of applying the rule of changed circumstances were difficult to meet and the legal consequences of the rule were not ideal for retail investors, or because retail investors possessed insufficient legal knowledge to apply the rule.

In order to end such disputes over structured notes, a new set of rules and regulations under the FCPA was eventually passed in 2011. Nevertheless, though the FCPA appeared to provide additional protection to financial consumers, it has not yet established an exclusive system to cover all financial consumer disputes. There is still room for the FCPA to be further improved and refined; we must continue to draw knowledge and experience from the designs of foreign professional authorities for consumer financial protection, such as the CFPB in the United States, as well as other practices used in different dispute-resolution civil procedures in Taiwan.

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