

Financial List decision significantly narrows applicability of Article 3(3) Rome Convention in interest rate swaps transactions

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In *Banco Santander Totta SA v Companhia de Carris de Ferro de Lisboa SA & others*, a decision with potentially significant implications for parties entering into interest rate swaps, the Court held that the requirements of Article 3(3) of the Rome Convention will not be met where there is any international element involved, even if that element does not specifically point to another country or legal system.

Facts

Between 2005 and 2007, several Portuguese transport companies (the Defendants) entered into a series of long-term interest rate swaps with Portuguese Bank Banco Santander Totta (the Claimant). The swaps were governed by ISDA Master Agreements subject to English law and jurisdiction.

The swaps included provisions which calculated fixed interest rates in such a way that resulted in very high cumulative rates. After the financial crash in 2008 those provisions magnified the effect of the reduction of interest rates, making the swaps extremely disadvantageous to the Defendants. The Defendants stopped making payments as required under the terms of the swaps and, in 2013, the Claimant brought proceedings to recover the unpaid sums.

Article 3(3) of the Rome Convention applies to contracts entered into before December 2009, and states that the fact that parties have chosen a foreign law to apply does not, where all the other elements relevant to the situation are connected with only one country, prejudice the application of the mandatory rules of that country. The Defendants argued that in this case all the relevant elements were connected with Portugal only, and so mandatory Portuguese rules must be applied to the swaps. The application of those rules would mean that (i) the Claimants lacked capacity to enter into the swaps on the basis that they were speculative transactions and "games of chance", and (ii) they were liable to be terminated under rules relating to "abnormal change of circumstance."

Decision

The Court disagreed with the Defendants' interpretation of Article 3(3), and held that it does not apply if there are any "international factors" present. Such international factors need not point to a particular country or legal system; it was enough that they point away from a purely domestic situation. In this case, the relevant international factors included the following:

- The Claimant had entered into back-to-back contracts with the Spanish Banco Santander Central Hispano SA ("Santander Spain"), and the participation of Santander Spain was practically necessary to approve and enable the swaps;
- The transactional documentation allowed for the substitution of the Claimant with a non-Portuguese bank (any subsidiary of Santander Spain);
- The use of international standard documentation (the "Multicurrency-Cross Border" form of the 1992 ISDA Master Agreement);
- English was used to set out the terms of the swaps and to confirm them (although the use of English would not, in isolation, be a relevant international factor);
- The swaps were concluded in an international market for over-the-counter interest rate derivatives, which is "necessarily international in its operation".

The Court concluded that, on the basis of the above factors, Article 3(3) was not engaged because not all the elements relevant to the situation were connected with Portugal. These were not purely domestic contracts and the choice of English law under the ISDA Master Agreement was upheld. Portuguese mandatory rules did not apply, and the swaps were valid.

Comment

The Court's approach in this case has the benefit of providing certainty in that parties to similar transactions can be confident that their express choice of law will be upheld. Indeed, applying this approach, it is difficult to conceive of

situations in which the requirements of Article 3(3) will ever be met in interest rate swap transactions, which so often rely on international standard documentation and involve financial institutions operating in different jurisdictions. However, unfortunately, there is still a lack of clarity for parties to these types of transactions, in that the Court's approach in this case conflicts with the Commercial Court's decision in the 2015 case of *Dexia Crediop SpA v Comune di Prato* [2015] EWHC 1746 (Comm). In that case, Walker J held that it was necessary for international elements to point to another country, rather than simply away from a domestic situation. It remains to be seen which view will prevail in future cases.

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