Briefing note March 2016

LIBOR-based defences rejected by the court

The Court of Appeal has rejected a miscellany of defences raised by a borrower based on the alleged rigging of LIBOR by a lending bank. The case may continue, but the Court also ordered the borrower to pay immediately the minimum sum for which, even if it succeeds, it will be liable to the bank. Allegations of LIBOR rigging will not allow an extended deferral of all payment obligations.

Key issues

- An allegation of LIBOR rigging will not put off all payment obligations
- The fact that the ultimate source of payments is India does not subject a transaction to Indian exchange control regulations
- Rules protective of guarantors do not apply to indemnifiers

Deutsche Bank AG v Unitech Global Ltd [2016] EWCA Civ 119 derives from a common situation. A borrower entered into a US$150m facility agreement and also an interest rate swap. Interest rates under both the loan and the swap were tied to LIBOR. The borrower alleged that the bank had been involved in rigging LIBOR.

If the borrower could only succeed in showing that the alleged LIBOR rigging constituted a breach of the agreements by the bank, the borrower would be entitled to damages, but those damages would probably be de minimis since they would be limited to the difference between LIBOR as it should have been and LIBOR as it in fact was on the relevant days.

As a result, the borrower also alleged that it had been induced to enter into the agreements by implied representations from the bank to the effect that LIBOR was genuine. The remedy for misrepresentation is rescission, ie treating the agreements as if they had never been entered into. In an earlier decision ([2013] EWCA Civ 1372), the Court of Appeal refused to strike out the allegation that the bank had made an implied representation to that effect, leaving the case to go to trial.

However, a condition of the court allowing rescission is that the parties are put into the position they would have been in had the agreements not been entered into. This requires the repayment of the principal amount of the loan, netted against all other payments passing between the parties. On this basis, the borrower would be obliged to pay the bank US$120m even if it won (as opposed to US$177m if it lost). The bank therefore asked for the immediate payment of US$120m.

At first instance, the judge held that the court's rules did not give him power to make this order (though the judge expressed some disquiet about this outcome).

Take or pay

The Court of Appeal considered that the court's rules were not so limited. Where the relief claimed by a party would be made conditional on a payment by that party, the court could order that the party make an interim payment to the bank of the sum in question.

However, that was not the order that the Court made. Summary judgment for the full amount claimed by the bank had been granted against the borrower at first instance, but then set aside following the Court of Appeal's earlier judgment referred to above. At the banks request, the Court of Appeal ordered that the setting aside of the first instance judgment should be conditional on the borrower paying US$120m into court, effectively as security for the bank's claim. As the borrower argued that it should not be ordered to pay this sum at all because it did not have the money to do so and its claims would therefore be stifled (arguments rejected by the court), the Court's bank accounts will presumably be untroubled. If so, the original judgment in the bank's favour for the full amount will stand.

Three blind mice

The Court of Appeal also rejected three other arguments put forward by the borrower as to why the underlying agreements should be held to be unenforceable.

First, the borrower had used the facility to fund various projects in India. It alleged that it would need to convert rupees derived from these projects into dollars in order to repay the bank, for which it would need exchange control consent from the Reserve Bank of India. The borrower contended that this consent would not be given.

Article VIII(2)(b) of the IMF's Articles of Agreement provides that an "exchange contract" contrary to exchange control regulations imposed consistently with the IMF's Articles is unenforceable. The borrower contended that the agreements with the bank were exchange contracts, performance would breach of Indian exchange control rules and, as a result, the payment obligations were unenforceable.

The Court of Appeal dismissed this argument as "hopeless". English authority establishes clearly that an "exchange contract" for these purposes is a contract for the exchange of one currency for another. The agreements in question required the borrower to pay dollars, not to exchange anything. The fact that the borrower might, in practice, have to exchange one currency for another in order to obtain the currency in which it had promised to pay did not render the payment obligation an exchange contract.

Secondly, the borrower argued that even if the agreements were not exchange contracts, Indian exchange control regulations made it illegal for it to perform its obligations. Since, in practice, it had to perform in India, it was discharged from its obligation by the doctrine of illegality in the place of performance – English courts will not require a party to do something that is illegal in the place where it must be done.

The Court of Appeal regarded this argument as "no more hopeful than the last". The agreements required the payment of dollars in New York. It was not illegal for the borrower to pay dollars in New York. The fact that the borrower might have to take preparatory steps in India in order to obtain dollars was not relevant.

Thirdly, the borrower's obligations were guaranteed. The guarantor argued that the bank had failed to disclose to the guarantor unusual features of the underlying agreement or the relationship between the bank and the borrower (including the bank's alleged involvement in rigging LIBOR) and, as a result, that the guarantor was discharged.

The Court of Appeal observed that the doctrine of unusual features in a guarantee was "something of a developing doctrine whose ambit is perhaps not entirely clear" (eg does it only apply to the terms of the underlying agreement or to surrounding circumstances as well?), but Court decided that doctrine had no application in the circumstances.

As is typical, the guarantee included a traditional guarantee (a secondary liability) but also an indemnity that, if for any reason the principal debtor was not liable, the guarantor would, as a principal, indemnify the bank for any resulting losses. Whatever its precise scope, the doctrine of unusual features in a guarantee had no application to indemnity obligations of this sort.

Conclusion

The Court of Appeal's earlier judgment allowed the borrower to pursue its allegation that the bank had made an implied representation regarding LIBOR. But the Court has refused to allow this allegation, which might reduce, but cannot extinguish, the borrower's liability, to enable the borrower to defer all payment obligations while the Court deliberates on the allegation. The borrower must pay immediately the sum it will be required to pay if it is ultimately proved to be correct.

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