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"Snowball" swaps enforced - again

The English Court of Appeal has confirmed the first instance decision that "snowball" swaps between Portuguese public transport authorities and a Portuguese bank but governed by English law can be enforced. The transport authorities could not use Portuguese mandatory laws as a justification for non-payment.

The message from *Banca Santander Totta SA v Companhia Carris de Ferro de Lisboa SA* [2016] EWCA Civ 1267 is that, if the parties to a contract have chosen English law as the governing law, the English courts will not readily allow another law to override English law. Another law might be relevant in a purely domestic transaction in the relevant country, but it will not take much to provide sufficient international elements to avoid the application of that other law.

Companhia Carris de Ferro de Lisboa concerned long term interest rate swaps entered into between June 2005 and November 2007 by a Portuguese bank and the authorities that run public transport in Lisbon and Porto. The authorities were the fixed rate payers. If the reference rates on the swaps moved outside upper or lower barriers, the fixed rates had a spread added to them. The spreads were cumulative (there was also leverage) so that, by the autumn of 2016, the fixed rates were between 30% and 92%.

At first instance in *Companhia Carris de Ferro de Lisboa* ([2016] EWHC 465 (Comm)), the transport authorities raised numerous arguments based on Portuguese law as to why the swaps could not be enforced. By the time the case reached the Court of Appeal, the argument focused on article 437 of the Portuguese Civil Code. Article 437 allows a contract to be terminated or modified if "the circumstances on which the parties based their decision to enter into a contract have undergone an abnormal change".

English law has a doctrine in the same broad area as article 437, namely frustration, but frustration is very narrow in scope, and would not apply merely because interest rates were persistently lower than anticipated. The transport authorities did not bother to argue that the agreements might have been frustrated as a matter of English law. If commercial parties agree particular terms, the general approach in English law is that those terms should be enforced even if they turn out to be severely disadvantageous to one of the parties.

Given the parties' choice of English law to govern the transactions, Portuguese law would only be relevant if "all other elements relevant to the situation at the time of choice" were located in Portugal (article 3(3) of the Rome Convention, now the Rome I Regulation). If so, the choice of English law would not prejudice the application of rules of Portuguese law that could not be derogated from by contract, including, arguably, article 437.

Key issues

- The need for certainty in financial transactions emphasised
- The international market and standard documentation contribute to guaranteeing the parties' choice of law prevails over local law

The question for the Court of Appeal was whether all the elements relevant to the situation were located in Portugal: the parties were both Portuguese and payments were required in Portugal.

The Court of Appeal decided that article 3(3) was an exception to the general principle of the parties' freedom of choice regarding the governing law of a contact and, as a result, was to be construed narrowly, ie sufficient international elements to exclude the application of article 3(3) should not be hard to find. The elements that could be considered for this purpose were not merely those that might influence a court in its decision as to the applicable law in the absence of choice or even that fell within the four corners of the contract.

In *Companhia Carris de Ferro de Lisboa*, the Court of Appeal considered that there were ample

international elements justifying Blair J's conclusion at first instance that article 3(3) did not apply. The Court was prepared to take into account the use of international standard documentation (the ISDA Master Agreement), the fact that the swaps were entered into in an international derivatives market, the fact that the benefit of the swaps was assignable to a non-Portuguese bank, and the hedging undertaken with non-Portuguese banks. As a result, the transport authorities could not rely on article 437 of the Portuguese law in order the escape from the swaps.

Of equal importance to the choice of law was the choice of court. Even though English law governed the agreements, if the matter had come before the Portuguese courts, they could, perhaps, have applied article 437 by virtue of article 9(2) of the Rome I Regulation ("Nothing in this Regulation shall restrict the application of the overriding mandatory laws of the forum") or article 21 (public policy of the forum). It was the combination of the choice of English law and the English courts that limited the argument to article 3(3) of the Rome Convention and resulted in the enforcement of the swaps.

Conclusion

If the parties to an agreement choose English law, particularly when accompanied by a choice of the English courts, in most cases they will not need to look beyond English law. Only rarely will a non-English law have any relevance.

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