

Swaps Litigation in Europe

- Danny Busch

Introduction

- **Many SMEs across Europe entered into interest rate swaps with banks**
- **Litigation in many European countries, including:**
 - **Scotland**
 - **England & Wales**
 - **The Netherlands**
 - **Germany**
 - **Spain**

Interest Rate Swaps

- **Loan to SME based on floating base rate (LIBOR / EUROBOR) + an additional fixed rate, largely depending on risk profile SME**
- **For a long time, base rate was moving upwards -> rise of funding costs for SMEs**
- **Conclusion of interest rate swap agreement (IRSA) to hedge the risk of a rising base rate on the underlying loan**
- **SME 'swaps' variable base rate against fixed interest rate with the bank -> the risk of a rise of the base rate above the level of the fixed rate is born by the bank**
- **Of course, the SME pays a fee for the conclusion of an IRSA!**

Interest Rate Swaps

- **Great Financial Crisis**
- **Decrease base rate from 2008 onwards -> negative value -> margin calls -> liquidity stress**
- **Early termination swap agreement possible, but at high costs!**
- **Early redemption underlying loan agreement -> automatic early termination swap agreement?**
- **Banks unilaterally increased the additional fixed rate on underlying loan -> not covered by IRSA -> rise of funding costs!**

Court of Session 21 August 2012 [2012] CSOH 133 (*Grant Estates Ltd v. The Royal Bank of Scotland plc*)

- **Grant Estates Limited (GEL) -> small property developer (SME)**
- **On 6 and 11 July 2007 it took out two loans with The Royal Bank of Scotland (RBS) for a total amount of £775,000**
- **The rate of interest on the loans was variable, namely 1.4% over base rate (which was 5.75% (LIBOR) on 6 July)**
- **In December 2007 RBS concluded with GEL an IRSA to cover the risk of a rise in interest rates on the underlying loans**
- **Great Financial Crisis!**

Damages claims for mis-selling the Interest Rate Swap Agreement (IRSA)

- **GEL sought, inter alia, damages for:**
 - **infringement of the financial supervision requirements of the Conduct of Business Sourcebook (COBS) issued by what was then the Financial Services Authority (FSA), now known as the Financial Conduct Authority (FCA) (these rules constitute the implementation of MiFID I in the United Kingdom)**
 - **negligent advice and negligent misrepresentation**
 - **breach of contract**

What prevails: the terms of the contract or the factual situation?

- GEL

- RBS staff had provided GEL with advice within the meaning of the FSA's supervision rules
- Applicable Terms of Business (ToB) clearly provided that the FSA rules prevail in the event of a conflict with the ToB
- Section 150 (now section 138D) of the Financial Services and Markets Act 2000 (FSMA), provides that a contravention of supervision rules issued by the FSA (now FCA) on the basis of Part X, Chapter I FSMA
 - '(...) is actionable at the suit of a private person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty.'
- Limitation to private persons in conflict with the EU legal principle of equal treatment

What prevails: the terms of the contract or the factual situation?

- Lord Hodge
 - MiFID I only provides protection under supervision law & makes no provision for protection under civil law
 - Limitation of section 150 FSMA to private persons is a choice made by the legislator in the UK even before the implementation of MiFID I and is not in any way connected with the MiFID I provisions
 - Not aware of any EU legal principle of equal treatment between corporate and private persons
 - As GEL was quite clearly not a private person but a corporate client, he held that GEL had no right of action under section 150 FSMA

What prevails: the terms of the contract or the factual situation?

- Lord Hodge
 - A contractual provision to the effect that the bank acts solely as contractual counterparty and not as advisor is applicable even where a bank employee does actually provide the client with investment advice as referred to in MiFID I
 - The aim of this provision is not to incorporate the COBS rules into the contract, which would mean that the classification as advice under supervision law would also apply for civil law purposes, including all supervision rules applicable to the advice

Negligent advice & negligent misrepresentation?

- GEL
 - negligent misrepresentation and negligent advice
- Lord Hodge
 - In so far as GEL relied on the statements of RBS staff as investment advice, this reliance was not justified in view of the background of the clear arrangements between the parties as contained in the ToB, namely that there was no investment advice relationship
 - Common law duty of care cannot be based on supervision rules

Breach of contract?

- GEL
 - The contractual provision that no advice would be given amounted to an exclusion of liability for incorrect advice and was therefore an unreasonably onerous clause to be incorporated in terms of business
- Lord Hodge
 - GEL agreed in advance the contractual definition of its relationship with RBS and must accept the consequences of that agreement on its contractual and other common law claims

Similar cases in England & Wales

- *Green & Rawley v. RBS* [2013] EWCA Civ 1197
- *Thornbridge v. Barclays* [2015] EWHC 3430 (QB)

The Dutch duty of care

- Dordrecht District Court, 29 February 2012, *RF 2012/48 (Bugro v. Rabobank)*
- In the light of what actually happened, the contractual provision that the bank did not provide advice had no effect since a bank employee had, in reality, provided investment advice to the corporate (non-private) client

The Dutch duty of care

- good faith (*redelijkheid en billijkheid*)
- unreasonably onerous general condition

The bigger picture & reform perspectives

- the role of the supervisor in settling disputes
- alternative dispute settlement (ADR)
- product governance & product intervention -> MiFID II
- reclassification of dealing on own account to dealing on behalf of the client -> MiFID II
- plain language
- financial literacy and financial education
- towards simpler financial products
- investor empowerment -> class actions
- nudging & behavioural economics for the benefit of the client (Dutch AFM)

Thank you for your attention!

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