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# Swap agreements and Italian local authorities: where now?

Swap agreements entered into by Italian local authorities remain the subject matter of litigation before the English courts, with some interesting outcomes that deserve the attention of anyone involved in Italy-UK cross-border legal work. In particular, with a recent judgment in *Banca Intesa Sanpaolo and Dexia Credit Local S.A. v Comune di Venezia*[1], involving an interest rate swap agreed by the City of Venice, the Court of Appeal allowed the appeal by the banks against the findings of the High Court. Furthermore, whilst the Court of Appeal has stated that it is following the principles established in the landmark judgment by the Italian Court of Cassation in *Banca Nazionale del Lavoro S.p.A. v Comune di Cattolica*[2], its findings significantly reduce the likely impact of the *Cattolica* judgment on any ongoing proceedings in the English courts concerning the same subject matter.

## Background

The factual background to the *Venezia* case is as follows:

**2002:** City of Venice issues a floating rate bond and enters into an interest rate swap with Bear Stearns to hedge against interest rate exposure under the bond.

**2007:** Bond is restructured, with its maturity extended by 15 years and an amended coupon. As Bear Stearns refuses to agree to any corresponding adjustments to the swap:

- Intesa Sanpaolo and Dexia Crediop (the "**Banks**") step into the shoes of Bear Stearns under a novation agreement;
- the Banks pay novation fees to Bear Stearns to reflect the value of the swap, i.e. the negative mark-to-market in its favour; and
- the swap is restructured so as to realign it to the bond.

Parties choose English law to govern the swap and English courts to hear any dispute.

**June 2019:** Despite the jurisdiction of the English courts, City of Venice issues proceedings against the Banks in Italy claiming breach of contractual and non-contractual advisory duties in relation to the swap transactions.

**August 2019:** Banks commence proceedings in English High Court, seeking declarations that swap transactions were valid and binding.

**May 2020:** Court of Cassation issues the *Cattolica* judgment.

**October 2022:** Based on an analysis of *Cattolica*, the High Court gives judgment[3] in favour of Venice on the grounds that:

- the swaps were speculative in nature rather than for the purposes of hedging;
- the novation fees to Bear Stearns were an up-front payment, meaning that the swaps constituted indebtedness other than for the purpose of financing investment expenditure; and
- as Venice lacked capacity to enter into such transactions, the swaps were void.

## Appeal

Following an appeal by the Banks against the High Court judgment, the Court of Appeal held as follows:

- *Foreign law matters*: The task for English courts toward disputed matters of foreign law was to ascertain what the highest court in the foreign legal system would have decided if the point had come before it, as directed in *Dexia Crediop S.p.A. v Comune di Prato* (another swap case previously heard by the Court of Appeal)[4]. The judge should have made that evaluation on the basis of the expert witness evidence, rather than embarking on his own analysis of judgments in swap disputes by lower courts in Italy, some of which were inconsistent with *Cattolica*.
- *Hedging vs speculative*: Following the above approach and in the absence of clear guidance in *Cattolica* on the distinction between hedging and a speculative transaction, a ruling by Consob[5] in response to a query was likely to be determinative, not least because it had been endorsed in a separate judgment by the Court of Cassation[6]. As a result, a swap transaction would be regarded as hedging if:
  - it was explicitly carried out to reduce the risks from an underlying debt instrument; and
  - there is a high level of correlation between the characteristics of the underlying debt and those of the derivative transaction.

  The Venice swap transactions satisfied the above criteria and, in particular, any variance between the swaps and the underlying bond simply reflected the novation of the original Bear Stearns swap in 2007 and the rolling-over of the negative mark-to-market to which Venice was already exposed.
- *Indebtedness / purpose of transaction*: As regards the question of indebtedness: (i) the payment of novation fees by the Banks to Bear Stearns was nothing more than that and did not constitute up-front payments to Venice thereby creating indebtedness; and (ii) since the swaps satisfied the hedging test, even supposing they did constitute "indebtedness", they were in any event linked to the original bond, the purpose of which was not being contested.

By reason of the above, there was no conflict with Italian law, in the view of the Court of Appeal, that would lead to a conclusion that the City of Venice lacked capacity to enter into the swaps.

## *Obiter dicta*

Although the above was sufficient to allow the Banks' appeal, the Court of Appeal made some interesting (but non-binding) findings on points that would have been relevant if its conclusions had been different:

- *Governing law of restitution claim*: Regarding any claim for restitution – that is, in a scenario in which the swaps were void, the right of Venice to be restored to its previous position on the basis that the Banks had profited from a contract that had turned out to be void – the Court of Appeal upheld the High Court's position that any such claim was governed by English, rather than Italian, law. Whether the swap agreements were valid was determined under the law which governed them if they were valid[7], which was English law. It therefore followed that English law was the law with which a restitution claim had its closest and most real connection.
- *Time limits*: Applying English law, a claim for restitution by Venice was time-barred under s32(1)(c) of the Limitation Act 1980, as the period of limitation was six years from the time when Venice discovered, or could with reasonable diligence have discovered, that the swaps were void. While the High Court regarded the *Cattolica* judgment in 2020 as the starting-point, the Court of Appeal found that time ran once it became apparent that Italian local authorities had worthwhile grounds to make a claim contesting the validity of swap agreements: for example, in the *Prato* claim referred to above, proceedings had been commenced in 2010.
- *Change of position*: The Court of Appeal upheld the finding by the High Court that, in principle, if Venice had a claim for restitution, the Banks had a defence under the doctrine of change of position, meaning

that they could argue against restitution where their circumstances had changed detrimentally: for example, as a result of any payments under back-to-back swaps.

## Other post-Cattolica cases

Two other judgments since *Cattolica*, both by the High Court, show an approach that is consistent with the *Venice* appeal judgment and have tackled the following additional issues raised by *Cattolica*:

- whether a swap agreement might be invalid in the absence of any indication of the measure of risk and, in particular, where the financial intermediary failed to provide mark-to-market valuations and so-called "probabilistic scenarios"; and
- the requirement under Article 42 of Legislative Decree No. 267 of 18 August 2000 (otherwise known as the *Testo Unico Enti Locali* or "**TUEL**") for certain "fundamental acts" to be submitted to the local authority's Council for approval.

The Hight Court's conclusions are summarised below.

- in *Deutsche Bank AG v Comune di Busto Arsizio*[8] in 2021, the court made the following findings:
  - any obligation to identify the risks properly would only apply if the swap agreements were governed by Italian law and did not affect the capacity of the Municipality of Busto Arsizio to enter into the transactions; and
  - the swaps did not require approval by the Municipality's Council, as they did not involve an up-front payment or otherwise make significant alterations to the underlying indebtedness;
- in *Banca Nazionale del Lavoro & Ors v Provincia di Catanzaro*[9] in 2023, the High Court held that:
  - the requirement to obtain approval by the Provincial Council under Article 42 of the TUEL was not a matter of capacity (i.e. whether or not the Province had the power to perform that kind of transaction) but of authority (whether the persons who signed the agreement were duly authorised by the Province's administrative bodies); and
  - there was clear evidence of conduct by the Province of Catanzaro that constituted not only ostensible authority (i.e. where Party A holds out to Party B that the persons entering into a contract on its behalf is duly authorised) but also subsequent ratification of the swaps, and both ostensible authority and ratification were matters of English law.

## Commentary

The *Venice* judgment and the two other post-*Cattolica* judgments by the English courts suggest that the position regarding the possible nullity of swaps established in the *Cattolica* judgment is not being readily upheld by the English courts. In fact, when called upon to apply the principles established by the Italian Court of Cassation (which, for that matter, are not crystal clear), the English courts appear reluctant to conclude automatically that swap contracts are invalid (as, for example, in relation to the failure to provide mark-to-market valuations and so-called "probabilistic scenarios"). Instead, they appear inclined to make a detailed and extensive evaluation of each claim on a case-by-case basis, reaching conclusions that do not appear to be fully consistent with the *Cattolica* judgment in relation to questions of capacity, the actual purpose of the swap agreement and the consequences of nullity.

[1] [2023] EWCA Civ 1482: https://www.bailii.org/ew/cases/EWCA/Civ/2023/1482.html.

[2] Judgment No. 8770/2020 (in Italian only): https://www.eius.it/giurisprudenza/2020/284.
This judgment has since been backed up by a further order of the Court of Cassation (No. 7368 of 19 March 2024).

[3] [2022] EWHC 2586 (Comm): https://www.bailii.org/ew/cases/EWHC/Comm/2022/2586.html

[4] [2015] EWHC 1746 (Comm): https://www.bailii.org/ew/cases/EWCA/Civ/2017/428.html.

[5] Consob Communication No. DI/99013791 of 26 February 1999:
https://www.consob.it/documents/1912911/1926871/99013791.pdf/b3a6f8ea-040e-d81f-66b6-8c5def90b6ab.

[6] Judgment No. 19013/2017, issued on 27 April 2017:
https://www.masterlegalservice.it/mls/wp-content/uploads/2017/10/Cassazione-Civile-Sez-I-31-luglio-2017-n-19013.pdf.

[7] Article 8(1) of the Rome Convention of 1980 on the law applicable to contractual obligations (applicable to contracts from 2007):
https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:41998A0126(02)

[8] [2021] EWHC 2706 (Comm): https://www.bailii.org/ew/cases/EWHC/Comm/2021/2706.html.

[9] [2023] EWHC 3309 (Comm):
https://www.oeclaw.co.uk/images/uploads/judgments/Judgment_FL-2022-000005_FL-2022-000007_FL-2023-000015_-_approved_for_circulation_120124.pdf.

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