

P.R.I.M.E. Finance

Panel of Recognized International Market Experts in Finance

Topic I: Characterization of Complex Transactions



P.R.I.M.E. FINANCE
Panel of Recognised International Market Experts in Finance



Antoine Maffei

P.R.I.M.E. Finance Annual Conference 2019
4 & 5 February, Peace Palace, The Hague

Post-Post-Crisis : New Trends in Financial Litigation

Prior to 2008 Financial Crisis:

- structured financing facilities, and/or
- Structured swaps

were offered to local governments and other public entities such as hospitals etc.

Rather than using a traditional benchmark such as EONIA or Euribor structured financing Interest was calculated by formulas using:

- an index, inflation rates, foreign currencies (in particular the Swiss Franc or the Euro); and
- a differential between the Euro versus the USD and the Swiss Franc, etc.



Post-Post-Crisis : New Trends in Financial Litigation

Structured Swaps as hedging tools of Structured Financing transactions

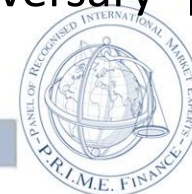
Those involve generally a rate of interest:

- set according to contractual formulas between a ceiling and a floor **on the receiving side**; and
- **on the paying side** a combination of a fixed rate in respect of the first maturities and for the later maturities a fixed rate increased by a multiple between 0 and the differential between the Euro versus the USD and /or the Swiss Franc all in accordance with a contractual formula.

In the aftermath of the 2008 Financial crisis municipalities and other public debtors became therefore exposed to contingent risks on account of:

- increased interest payments;
- or swap payments, as the case may be.

This situation triggered a substantial number of adversary proceedings against relevant institutions.



Post-Post-Crisis : New Trends in Financial Litigation

Among arguments raised by public debtors the following pattern appears:

- Characterization of the Loan as a structured borrowing consisting of a mix of fixed rates components and financial instruments (**including a foreign exchange option**) which leads to the conclusion that the product included speculation features which would trigger MIFID disclosure requirements with resulting potential nullity risk;
- Failing such characterization, breach of civil law reinforced duty of information and disclosure vis à vis an unsophisticated borrower (*non averti*) or counterparty;
- Fraud (DOL) which may also lead to potential nullity.

Of particular relevance is the characterization of the debtor as a professional or sophisticated entity which is heavily fact sensitive.



Post-Post-Crisis : New Trends in Financial Litigation

Decisions at the lower court level are not consistent although characterization of transactions as:

- financial instrument transactions, or
- the retention of fraud (“Dol”),
 - have not been retained in respect of structured loan transactions and
 - fraud has not been retained in respect of swaps.

Some lower courts have awarded damages based on a reinforced duty of information in case of an unsophisticated debtor or counterparty which that borrower or counterparty claimed to be.

At the appeal level a number of judgments have been reversed based on the fact that the debtor or counterparty was a professional where the lower court ruled otherwise.



Post-Post-Crisis : New Trends in Financial Litigation

Two recent Supreme Court decisions:

- **March 28 2018** the French Supreme court has upheld a Court of Appeal of Versailles decision holding **in respect of a structured loan** that:
 - The transaction under consideration did not include an option nor was it speculative (the mode of calculation of the rate of interest was determined in detail at the time of conclusion of the structured transaction without need of a positive action of the debtor to trigger an option).
 - The debtor was a sophisticated entity (which excluded contract liability exposure from the lender).
 - Absence of fraud (taking inter alia into consideration the fact that the court of appeals had determined that the debtor was a sophisticated person).



Post-Post-Crisis : New Trends in Financial Litigation

- **September 5 2018** the French Supreme Court upheld a Paris Court of Appeal decision in respect **of a structured swap** holding that such swap:
- constituted a **hedging transaction** and **not a speculative transaction** where its purposes are protection against the evolution of rates and the reduction of the overall cost of a debt, even if such contract has an inherent random nature and its conclusion may expose one of the parties to unlimited risk;
 - did not involve an option (this is in line with the above French Supreme Court decision of March 28).
 - The hedging bank had met its disclosure requirement *visa vis à vis* its hedging counterparty which was determined to be a sophisticated investor.

A number of other matters are still pending before the French Supreme Court some of which are expected to be ruled shortly.



Post-Post-Crisis : New Trends in Financial Litigation

Question: How would those questions be addressed in other jurisdictions in respect of government or local authorities with regard to those types of structured finance transactions or derivatives (hedging or speculative derivatives)?

