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IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
COMMERCIAL COURT
FINANCIAL LIST

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Royal Courts of Justice, Rolls Building
Fetter Lane, London, EC4A 1NL

Date: 04/03/2016

Before :

MR JUSTICE BLAIR

- -

BETWEEN:

BANCO SANTANDER TOTTA S.A. — **Claimant**

- and -

COMPANHIA DE CARRIS DE FERRO DE LISBOA S.A. — **Defendants**
SOCIEDADE TRANSPORTES COLECTIVOS DO PORTO S.A.
METROPOLITANO DE LISBOA E.P.E.
METRO DO PORTO S.A.

- -
- -

LAURENCE RABINOWITZ Q.C., JOHN ODGERS Q.C., SIMON COLTON, and MEHDI BAIOU (instructed by **Slaughter and May**) for the **Claimant**
ALI MALEK Q.C., RICHARD BRENT, and KATE HOLDERNESS (instructed by **Lipman Karas LLP**) for the **Defendants**

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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MR JUSTICE BLAIR

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Mr Justice Blair:

PART A: INTRODUCTION

1. The claimant, Banco Santander Totta S.A. (which was formed by the merger of Banco Totta & Açores, S.A. and two other Portuguese banks) is a Portuguese bank, and a member of the Banco Santander group, the global banking group based in Madrid, Spain. It is referred to in this judgment as "**BST**" or "**the bank**".

2. The defendants are public sector Portuguese transport companies which run the metro, bus and tram services which serve the cities of Lisbon and Porto, Portugal. They are:

   (1) Companhia de Carris de Ferro de Lisboa, SA, referred to in this judgment as "**Carris**";

   (2) Sociedade Transportes Colectivos do Porto SA, referred to in this judgment as "**STCP**";

   (3) Metropolitano de Lisboa EPE, referred to in this judgment as "**MdL**";

   (4) Metro do Porto SA, referred to in this judgment as "**MdP**".

   The defendants are referred to as a group as the "**Transport Companies**".

3. These proceedings relate to long-term interest rate swaps entered into between the bank and the Transport Companies between 6 June 2005 and 2 November 2007. The swaps were entered into under ISDA Master Agreements subject to English law and jurisdiction.

4. Nine such swaps are the subject of the claims. The terms differ, and are set out in agreed tables in the Annex to this judgment. There is a summary table in paragraph 150 below.

5. Generically, these are so-called "exotic" swaps, as opposed to so-called "vanilla" or "plain vanilla" swaps which involve the simple swapping of a fixed for a floating rate of interest or vice versa.

6. In these cases, the bank was the floating rate payer[1] and the Transport Companies were the fixed rate payers. What makes the swaps unusual was the incorporation of a "memory" feature. Speaking generally, once the reference interest rates (EURIBOR and sometimes LIBOR) moved outside upper or lower "barriers", the fixed rate payable by the Transport Companies had a "spread" added to it. The spread was cumulative at each payment date, and was subject to leverage (in all but one swap), hence the swaps being described as "snowball" swaps.

7. The spread provisions took effect after a "holiday" which varied from between six months and four years. Five of the swaps incorporated "mitigating" features, one being a "reset", and the others being designed to bring rates gradually down when

[1] With one exception, MdP 1, see below.

interest rates moved back within the barriers (though as explained below these have not taken effect).

8. Though initially providing positive cash flows for the defendants, the result of sustained near zero interest rates since 2009 following the financial crisis together with the memory feature and leverage has been to activate the spread, very substantially increasing the interest rates payable by the defendants under the swaps. The mark-to-market value of the swaps has also been affected. By 1 October 2015, their combined MtM value was negative[2] in an amount in excess of €1.3 billion.

9. The Transport Companies ceased to make payments under the swaps in 2013, and as at 1 October 2015, the total unpaid amount is stated to be €272,561,157.

10. Given the number of disputes relating to swaps which have arisen in different countries following the financial crisis of 2007-8, it is important to emphasise that the swaps the subject of this case are of a very particular type, and are not to be compared to vanilla swaps. The latter may have typically turned out to be disadvantageous to the party paying the fixed rate, but the results are not comparable to the effect of the "snowball" structure on these swaps. It does not appear that swaps of this type have been the subject of the decision of a court of law, at least none were mentioned at trial.

11. The position has arisen because the structure of the swaps has resulted (in all but two cases) in the magnification of the effect of sustained near zero interest rates. Among other things, this has prompted detailed submissions by the parties as to interest rates before and after the financial crisis in order to assess the defendants' contention that, in the case of these swaps, there has been a fundamental change in circumstances since the contracts were entered into. This enquiry was conducted with expert evidence from leading economists.

The issues and the parties' contentions

12. BST claims declarations that the defendants' obligations under the respective swaps constitute legal, valid and binding obligations, enforceable in accordance with their respective terms, together with payment of the sums due or damages in the same amounts. The total unpaid amount as at 1 October 2015 is stated by BST to be €272,561,157, a figure which has not been disputed.

13. This is not a "derivatives mis-selling" case. The Transport Companies do not assert that BST wrongly advised them to enter into the swaps, or misrepresented the swaps to them.

14. The defences raised by the Transport Companies are that:

(1) under Portuguese law, each company lacked capacity to enter the swaps which are therefore void; this is on the basis (among other reasons) of an assertion that the swaps were speculative transactions; this defence applies regardless of the law applicable to the swaps; it is common ground that, if correct, it is a complete answer to the claim;

[2] From the perspective of the Transport Companies.

(2) although English law governs the Master Agreements, this is subject to Art. 3(3) of the Rome Convention; this provides that where all the elements relevant to the situation at the time of the choice of law are connected with one country only, the choice does not prejudice the application of rules of the law of that country which cannot be derogated from by contract ("mandatory rules"). Portuguese mandatory rules apply to the swaps, giving rise to two defences:

a) under rules dealing with gaming and betting and *ordre public*, the swaps are void for being unlawful "games of chance", alternatively speculations;

b) seven of the nine swaps are liable to be terminated under rules dealing with an "abnormal change of circumstances" (which termination takes effect as though the swaps were void); this is on the basis that since 2009 (following the financial crisis), the reference interest rates relating to the swaps (EURIBOR and LIBOR) have been close to zero (and remain so at the time of this judgment);

(3) in presenting the swaps to the Transport Companies, the bank acted in breach of its duties under provisions of the Portuguese Securities Code which implement relevant European Union legislation; these apply to the bank as a financial intermediary and relate to the protection of the legitimate interests of the Transport Companies as clients, and to conflicts of interest; the breach is said to entitle the Transport Companies to damages thereby extinguishing their liabilities under the swaps.

15. On these grounds, the Transport Companies claim declarations that the swaps are invalid and unenforceable, alternatively have been terminated, and seek restitution of all sums paid (giving credit for all sums received from BST under the swaps), alternatively seek damages for breach of duty in the amount of the difference between the amounts paid to BST, less the amounts received. In terms of quantum, the Transport Companies state that their submissions will follow the court's determination of both liability and various legal issues arising in connection with the remedies sought. The court has not been concerned at trial with quantum.

16. Each of the defences raised by the Transport Companies is denied by BST. It asserts that:

(1) the swaps were within the capacity of each of the Transport Companies;

(2) the choice of English law is not dis-applied under Art. 3(3) of the Rome Convention, and further the provisions of Portuguese law dealing with abnormal change of circumstances are not "mandatory" so that the issue does not arise in this regard;

(3) further, the provisions relied on by the defendants as to gaming and betting, abnormal change of circumstances, and the Securities Code do not apply or have not been breached.

17. There are subsidiary issues between the parties relating to remedies, limitation, and representations which are identified below.

18. As explained below, subject to certain discrete points, the parties dealt with the issues on a common basis.

The trial

19. There are five separate claims. The claims in all but one action were issued on 10 May 2013. In the case of Banco Santander Totta SA v Metro do Porto SA CL-2013-001112 (formerly Claim No.2013-752), the claim was issued on 30 May 2013.

20. As indicated, the claims mainly raise issues which are common between the Transport Companies, and have been dealt with together by both parties.

21. However, there are significant differences between the terms of the swaps as to the initial "holiday", interest rates, duration, leverage and the like. Also, two were not structured with lower barriers (which is the primary cause of the losses) and five have "mitigating" features. The details of the swaps are set out below.

22. Also, it has been necessary to appraise some of the evidence by reference to the companies individually, and there are some discrete issues that apply to individual companies, for example, in relation to capacity; in relation to the change of circumstances, the defence applies to seven out of the nine swaps. Other instances are identified below. Subject to such instances, it is common ground that a common approach is appropriate, and the court has approached the case in the same way as the parties approached it at trial and in their closing submissions.

23. On the application of the parties, the proceedings were transferred into the Financial List on 12 October 2015, the first case to be heard in the list.

24. As well as brief oral submissions, the parties submitted substantial opening and closing submissions in writing.

25. The court has taken all the submissions made to it by the parties into account, even if not mentioned specifically in this judgment.

26. The factual evidence given orally at trial was as follows:

(1) For BST:

a) Ms Cristina Antunes (Maria Cristina Machado Beirão Reis De Melo Antunes), Head of Structuring Team (Institutions & Corporates) (2000-2007); Head of Financing Solutions & Advisory (2014-present).

b) Mr Daniel Pires (Daniel Cabrita Alves Pires), Member of Corporate Sales Team from 2000 until July 2011 (Head of Corporate Sales (2008-2010)), currently Head of the Communication and Sales Department (Corporate and Commercial).

(2) For the defendants:

a) Mr Pedro Pinto (Pedro Nuno Laranjo Ferreira Pinto), Economist in MdP's Planning Department January 2002 - to date.

b) Ms Alzira Peres (Maria Alzira Matos Peres), Member of the Administration and Finance department at STCP.

c) Ms Isabel Cabaço (Maria Isabel Gaspar Cabaço Antunes), Board member responsible for Finance Department and for the Planning and Management Control Department at Carris (2006-2012).

d) Mr Tiago dos Santos (Tiago Alexandre Carvalho dos Santos), Financial Director and Board Member at Carris.

e) Ms Inês Lourinho (Maria Inês Aguiar Ramos Lourinho), Head of Financial Management Division at MdL (1990–2012).

27. Written evidence from Mr Pedro Henriques of BST as to payments etc was not in dispute. MdL served written evidence from its CFO at the relevant time, Mr José O'Neill, though he did not attend the hearing.

28. Expert evidence at trial was given under three subject matters:

(1) Portuguese law:

a) For BST:

i) Professor David Duarte, Professor at the Faculty of Law of the University of Lisbon (concerning capacity).

ii) Professor Paulo Câmara, Professor at the Faculty of Law of the Catholic University of Lisbon (concerning all other Portuguese law issues).

b) For the Transport Companies:

i) Professor José Engrácia Antunes, Professor of Law at the Portuguese Catholic University (concerning capacity).

ii) Professor Manuel Carneiro da Frada, Professor at the Faculty of Law of Oporto University (concerning the abnormal change of circumstances issues, the Portuguese Securities Code issues, the affirmation issues, and the remedies issues).

iii) Professor José Lebre de Freitas, Professor of Law at the New University of Lisbon (concerning the games of chance issues).

(2) Interest rates:

a) For BST: Professor Charles Wyplosz, Professor of Economics at the Graduate Institute in Geneva, Switzerland.

b) For the Transport Companies: Professor Giancarlo Corsetti, Professor of Macroeconomics at the University of Cambridge, England.

(3) Swap transactions:

a) For BST: Mr David Evans, Banking and Finance Industry Consultant.

b) For the Transport Companies: Mr Ivan Harkins, Director of JC Rathbone Associates Ltd.

29. The court was assisted by the evidence of all these witnesses. Any further comments that are necessary appear below.

PART B: THE FACTS

30. The facts are complex, but for the purposes of the trial have been simplified as follows:

(1) There is an agreed chronology as regards the swaps for each of the defendant companies. For the most part, the specifics of the sales process are not relevant to the issues in dispute.

(2) There is also an agreed chronology as regards the swaps for IGCP, the Agência de Gestão da Tesouraria e da Dívida Pública (the Agency for the Management of the Treasury and Public Debt), the public body which since 2012 has managed and coordinated the funding and debt of public sector bodies in Portugal including the swaps entered into by the Transport Companies.

(3) There are agreed tables which set out the primary facts as regards the contractual structure of the nine swaps at issue in the case. These tables are annexed to this judgment.

31. In the event, the great majority of the factual matters in these actions were not controversial. The court’s findings of fact on the evidence are set out in this judgment.

The defendant companies

32. The defendants are public sector Portuguese companies which run the metro, bus and tram services in Lisbon and in Porto, Portugal. They are state owned (in the case of MdL, Carris and STCP) or state and local authority owned (in the case of MdP). There are differences in the incorporation and legal regimes of the companies which are relevant to the capacity issue and which are addressed below.

33. So far as their operations are concerned, the evidence is that:

(1) **Carris** was formed in 1872, and operates the bus, tram and funicular (*elevadores*) system in Lisbon.

(2) **MdL** was founded in 1948 and operates the underground metro system in Lisbon.

(3) **STCP** was established in 1994 (the successor of a company established in 1950) and operates the bus and tram services in Porto.

(4) **MdP** was set up in 1993, and operates the metro system in Porto (part of which is underground), which started operating in 2002.

The background to the swap transactions

The parties' relationship

34. It needs to be said at the outset that there are documents that, though not typical of the overall documentation, do the bank no credit. A presentation of November 2005 from Global Treasury (so *not* emanating from Portugal) aimed at boosting the sale of "exotic products" encourages employees to "Think Big: don't criticise ourselves. Reward Aggressiveness." As the Transport Companies point out, the first Lisbon Metro swap (MdL1) is placed at the top of the list of major deals completed in September 2005 internationally, with a profit of US$7,562,500. This kind of attitude is the antithesis of relationship banking.

35. The position in Portugal was as follows. There were at the material times two Portuguese subsidiaries of Santander, Banco Santander de Négocios Portugal SA ("BSNP") and BST itself. BSNP had client relationships with the Transport Companies and presumably other public sector companies, but their case is that in practice no distinction was made between the banks in their dealings with them. The Transport Companies place reliance on (among other things) a BST report of 20 June 2007 to show that the bank used its relationship with them to position itself favourably for the sale of structured products like the snowball swaps.

36. The report of 20 June 2007 was prepared by BST for Santander's New Products Committee mentioned further below. It covered the Sale of Structured Derivatives for the Public State Sector ("sector público estatal" or "SPE"). Each of the Transport Companies was named, as well as other public sector companies in Portugal the names of which have been redacted.

37. The report gives what the court regards as a not fully accurate view of the sales process, in particular a reference to stress testing for "extreme scenarios". In fact, BST only provided stress testing for three of the swaps, two of them being the last of the swaps entered into after the report. Only the last (the STCP swap) was tested for what could be described as extreme scenarios (in accordance with further requirements imposed by Madrid as described below).

38. Further, as the Transport Companies point out, these products were important from BST's point of view because (as it was put in the conclusion to an internal memo from August 2007), "The marketing of sophisticated Derivatives is essential for us to be players in the Large Corporates segment in Portugal and is the only way of complying with the budget". This shows that an important part of the motivation of BST's investment banking team in selling them to public sector companies was to meet its budget (this may be a reference to a target, and any difference is not material).

39. Broadly the court accepts that the report of 20 June 2007 shows BST using its relationship with the public sector companies to develop the derivatives business. However, that in itself is not a matter for criticism. An assertion is made by the Transport Companies in closing (BST says it is an un-pleaded point) that BST intentionally took advantage of the relationship, in the sense of unfair advantage. Whether pleaded or not, it is important that the court expresses its view on this.

40. There is nothing (in the court's view) in the report to suggest that the bank was intent on taking unfair advantage of its position. The evidence of Ms Cristina Antunes, who was a signatory, and the senior BST witness at trial, is also important in that respect. The court has had to assess her as a witness. It considers that she was, and is, committed and driven, not least by this litigation. She was an exceptionally well prepared witness dealing with events that began over a decade ago.

41. The court does not consider that she (or her colleagues) set out to persuade Transport Companies to enter into contracts that she thought would be contrary to their interests. The 20 June 2007 report supports the conclusion that the derivatives were seen at the time as advantageous to the bank but also to the clients. The court finds that these swaps were entered into because they suited both parties at the time: the bank got to enter into very profitable transactions, and the Transport Companies got appreciably lower interest rates than they would otherwise have been paying. However, this was at a price in terms of risk, and much of the dispute in this case turns around this equation.

The position of Santander Spain

42. New products such as complex derivatives had to be approved by the New Products Committee of Santander Spain. Above a certain limit, transactions had to be approved by the Credit Risk Committee in Spain. Each transaction also had to be within the approved "REC" for the client. The REC was calculated by a department in Spain called "Canal Transaccional" by an analysis which sought (as it turned out unsuccessfully) to determine "with a confidence level of 97.5%" the maximum potential loss over the lifetime of the derivatives transactions.

43. Despite the exhortation in the 2005 presentation quoted above to "reward aggressiveness", there were concerns in Santander Spain over the sale of snowball swaps to public sector companies in Portugal. An email of 30 September 2005 from Santander's Head of New Products in Madrid described a snowball swap structure as carrying a "great risk for the client". As he explained, and indeed as is obvious, this is because of the accumulative effect of the structure if interest rates rise above the barrier. He mentions rates rising, because that was presumably seen as the main probability at the time, but his point is equally applicable to rates falling below the barrier.

44. The risk was to the bank as well as the client. An email of 18 December 2006 from the credit risk department in relation to the first Porto Metro swap (MdP1) noted that "the proposed structure is equivalent to others the bank has been rejecting in Spain for being very speculative and there is a reputational risk that the bank will not want to run".

45. However, Santander Spain was not directly involved with the negotiating or transacting of the swaps, which was handled by the officers of BST in Portugal.

46. Based on a statement in the email of 30 September 2005 that "if there's no mistake, we are not aware that this product is approved for Portugal", the Transport Companies' case is that for some time BST was selling these products without proper approval from Spain. However, it seems that Ms Antunes was relying on a general approval given in 2001 or 2002 for BST to sell derivatives, and it seems unlikely that the products lacked whatever approval was necessary since a further seven snowball swaps were sold to the Transport Companies over the next two years.

47. The New Products Committee report of 20 June 2007 was the subject of an oral presentation by BST to the Santander Risk Committee (the CDR) in Spain on 24 June 2007, which is also important. The minutes make reference to the characteristics of the products that BST was selling to public sector companies (including the Transport Companies) in Portugal. They are described as having:

> "• High degree of complexity, featuring characteristics or components which involve the possibility of leveraging and granting them a speculative nature (and not just interest rate risk coverage)
>
> • Its purpose is the dynamic management of the counterparties' financial costs, facilitating interest rates lower than market ones as compensation for the speculative options sale
>
> • Long-time expirations, associated with the Debt being covered."

48. Nobody at the meeting gave evidence at trial, but the tone appears from the minutes. The Credit Committee is recorded as expressing its "concern for the reputational risk associated with these operations". However, it decided that the operation could be continued subject to more rigorous requirements. These were given in a document emanating from Madrid headed (in translation) "CNP – SPE[3] Structured Derivatives Operative" (it is not dated). The document emphasises a number of points: the importance of stress testing so that the client understood the risks, making alternative options available to the client, and making sure the client was not making a "merely speculative transaction".

49. Ms Antunes' evidence was to the effect that these were reinforcements of existing requirements, which may be correct. As to "merely speculative transactions" which the document makes clear were prohibited, her evidence was that what this meant was that the bank had to make sure that the purpose of the clients was not to speculate but to manage financial costs, which she said in these cases it was.

50. Overall, the court is satisfied that the requirements for selling these products had been reinforced because Santander Madrid had become more aware of the risks of this business. In fact, by the time of the new requirements, all but two of the swaps had already been transacted. The first exception was the second MdP swap with a trade

[3] Sector público estatal: see above.

date of 13 August 2007—this turned out to be less malign than the others, since it had no lower barrier. The other exception was the STCP swap with a trade date of 2 November 2007 (see below).

The alleged financial sophistication of the Transport Companies

51. BST's case is that it dealt with long-term and experienced finance managers at the Transport Companies. They were well qualified for this task, it says, being professional, sophisticated and highly knowledgeable in the way in which they negotiated the swaps. Overall, the boards included a number of individuals with substantial financial and economic experience. On this basis, it asserts the "financial sophistication" of the Transport Companies which, it says, fully understood the swaps they were entering into, and entered into them with good reason, as a means of managing and, it was hoped, reducing their interest rate liabilities as much as possible in return for taking on what they considered to be an acceptable level of risk.

52. The Transport Companies say that it is implicit in BST's internal email correspondence that it gave little or no thought to the Transport Companies' sophistication: the individuals dealing with the Transport Companies were sales people, and they viewed the Transport Companies as sales targets who had to be persuaded to buy their products. Their case is that they were not financially sophisticated in the context of the complex instruments with which they were being presented, and that the evidence shows some basic misunderstandings on the part of those responsible for the negotiations, such as to pricing and spread.

53. In support of its case, BST relies on the testimony given by the people heading up the Transport Companies to the Parliamentary Inquiry established to investigate the position of public sector companies in the light of the swaps debacle. The Inquiry is dealt with below.

54. BST says that it shows that the directors and employees of the companies acted with proper motives to protect the interests of the companies and their shareholders, that the swaps were concluded for a good commercial purpose, namely to reduce the overall interest burden of the Transport Companies; and that none of the companies had any intention of speculating, or gambling, or trading in swaps, nor saw the swaps in such light. No-one who gave evidence to the Parliamentary Inquiry expressed any doubt that the swaps were within the capacity of the Transport Companies.

55. That evidence, BST says, also highlights the fact that, in deciding to enter into the swaps, the Transport Companies engaged in a proper process, with careful analysis by suitably qualified and experienced in-house experts, inviting competitive proposals from multiple banks (both Portuguese and international); they were aware of the risks that they ran, but regarded them as worth running in return for the rewards available; and they did not feel under any pressure from any bank to conclude a swap, and in the same circumstances (ignoring hindsight) would make the same decision again.

56. The Transport Companies say that it is easy to understand that the individuals giving evidence before the Inquiry were "on the defensive". It is unlikely that they would accept that the swaps were high risk, speculative transactions, wholly unsuited to the Transport Companies' purposes, as this would have opened them up to criticism in a very public forum. For the same reason, it is unlikely that they would accept that they

did not fully understand the risks of the instruments when they authorised the Transport Companies to enter into the swaps, regardless of the true position.

57. The court thinks that there is force in the Transport Companies' contention. It is plain and not surprising that the problems with Portuguese public sector companies and the derivatives products they were sold has become highly politicised. The evidence given to the Inquiry (confirmed by some of the witnesses at trial when they were taken to it), while relevant in some respects - for example it is correct that no-one who gave evidence to the Parliamentary inquiry expressed any doubt that the swaps were within the companies' capacity - is part of the background, but should not be given undue weight.

58. The court has of course heard oral evidence from a number of people employed in the Transport Companies' finance departments at the time. They were not in the court's view at a particularly high level of financial sophistication, and obviously not on a level with a major international bank when it came to appraising derivatives products like the swaps in this case.

59. BST remarks on what it calls the "unexplained absences" of potential witnesses from the trial. It says that witnesses have stayed away not least because they would have been exposed to questioning about their wider experience with swaps.

60. It is correct that there were other people who could have been called, and who may have given further insight into the available financial expertise. However choices were inevitable in these complicated proceedings, and there is no reason to comment adversely on the Transport Companies' choice of witnesses.

61. On a similar point, BST points out that the disclosure exercise did not extend to the Transport Companies dealings with other banks. But again this is not a matter of criticism. Disclosure was already a massive exercise, and would have been rendered unmanageable if the entire swaps experience of the Transport Companies had been included.

62. The court's conclusion is as follows. Overall, whilst it is important not to underestimate the expertise of the companies, each of which had competent finance departments, the expertise of the Transport Companies in the context of these swaps can be described as "adequate", rather than "sophisticated" as BST has sought to argue.

63. There is no need to make any further finding. It is not suggested that their financial sophistication, even if that description is justified, had any regulatory consequences. It is said to matter on the Art. 437 issue, though the court does not consider that it makes a difference there either on the facts.

64. In any case, to brand the companies as "financially sophisticated" does not assist much in determining the substantive issues. In this context, particular issues are as to the purpose of the swaps, and the Transport Companies' understanding in entering into them. Both of these are dealt with below.

Whether the Transport Companies understood the risks

65. BST emphasises that the Transport Companies do not plead that they did not understand the risks they were assuming by entering into the swaps, or that they should have been given more information to enable them to do so. It is not, as they themselves say, a mis-selling claim.

66. The court accepts that this point on the pleadings is accurate.

67. On the other hand, as the Transport Companies say, by insisting that they are (or were) financially sophisticated, and indeed positively asserting that they fully understood the risks, BST has put the question of their understanding into issue. The Transport Companies are obviously entitled to put their case in that regard. Its relevance depends on the individual defences.

68. BST's case is that the Transport Companies had a full understanding of the risks to which the swaps exposed them (albeit that they considered these remote), but also of the benefits the swaps were capable of producing. They understood the way the swaps worked, including the memory effect (the snowball mechanism) which could expose them to accumulating interest rates, and they understood that their liability under the swaps was potentially uncapped.

69. In response, the Transport Companies do not question that they were sufficiently sophisticated to understand how in mathematical terms the coupon formulae of the swaps worked: as Ms Antunes said, "the memory formula is very straightforward to understand".

70. What the Transport Companies were not sufficiently sophisticated to understand, they say, were the possible permutations and combinations of actual outcomes i.e. not how the swaps worked mechanically, but the actual risks of the swaps. They say that the historical data, the forward testing and limited stress testing provided by BST was wholly inadequate to inform them about the real risks of the swaps. Their lack of understanding in that regard was not apparent to them when they entered into the swaps, and, indeed, it probably did not become apparent to them (if at all) until they realised that the swaps had had disastrous consequences which they could not manage.

71. In deciding this dispute, there are a number of specific matters to discuss.

(i) Selling volatility

72. The Transport Companies say that the possibility of accumulating interest rates are not the only risks inherent in these swaps. They say that the risks can be illustrated by likening the snowball spread to a series of options. The Transport Companies were, as they put it, selling volatility to the bank in return for low interest rates.

73. BST does not accept the option analysis, but the court thinks that it is broadly correct. There were not of course true options in the swaps, which appears to be Mr Evans' objection, but there was similar functionality, and there is some evidence that BST itself recognised this functionality as part of the price (see below).

74. The main point the Transport Companies derive from this is that the swaps are highly sensitive to volatility (that is, changes in interest rates), which affects the mark to market (MtM) value of the swap. It is therefore, they say, a mistake to solely focus on what is payable by way of spread when considering the risks of the swaps.

75. This risk was described in the evidence of Mr Harkins, who said that in the case of very small shifts in the forward interest rate curve, the MtM of a snowball swap would behave similarly to that of a vanilla swap. But as the shifts in the forward curve get larger, the MtM decreases rapidly and in a non-linear fashion (in contrast to the linear movements of the MtM of a vanilla swap). Well before the forward curve reaches the swap barriers, the negative MtM of the swap is in the tens of millions.

76. Likewise, because of their sensitivity to different variables, even though the trend in value is firmly downwards, the MtMs of these swaps can and have increased and decreased sometimes sharply despite the fact that interest rates have been held at a steady, low level.

77. It is believed that this evidence is not disputed, and the court accepts it.

(ii) The overall picture

78. Turning to the picture as a whole, as BST says, one of the chief challenges for each of the Transport Companies was to manage its mounting debt and funding needs. The evidence suggests that this is typical of large public transport systems.

79. It is not in dispute that derivatives played an important part in reducing the Transport Companies' interest rates before the financial crisis struck.

80. The Lisbon Metro (MdL), the biggest of the companies, entered into numerous swaps, including snowball swaps with other banks.

81. BST relied on the following:

(1) Lisbon Metro's 2004 accounts showed a reduction in debt related interest rates to 3.74%, from 4.36% in the previous year. The next year, the accounts showed a further reduction to 3.19%, and, in 2006, it reported that its policy measures relating to funding and derivative market involvement had reduced the rate to 2.67%. In 2007 its debt interest rate had fallen again to 2.58%.

(2) BST says that its use of the derivatives had saved it €83.9m in the previous two years, including €58.6m in 2007. These figures have not been disputed.

(3) The position of the other companies is different, in that none entered into swaps in the volume that MdL did. Nevertheless, each did enter into other swaps, including with banks other than BST, and for the same purpose.

(4) In its case, Metro Porto (MdP) received proposals for snowball swaps from Barclays and BNP Paribas but decided to go with BST (MdP 1).

(5) In its 2006 Report and Accounts, Carris said it had made €7.3m in profit on swap transactions in 2005 and 2006, which contributed to covering the costs of additional debt that was taken on and higher interest rates generally.

(6) The Transport Companies say that in the case of Carris and STCP it is evident from internal BST emails in June 2008 that the individuals in those companies were considered less knowledgeable and sophisticated than MdL and MdP.

(7) But the associated indebtedness in connection with the swaps of Carris and STCP was substantial and of the kind that must have required some financial expertise to manage.

(8) STCP's swap was in respect of part of the interest liability under a €100m bond issue, and it entered into a swap with a French bank at the same time.

(9) Carris had entered into swaps with other banks, and the BST/Carris swaps were in respect of bank loans of €90m and €100m respectively.

82. Mr Pinto of Metro Porto said in his witness statement that, "Many banks proposed snowballs swaps – they were not proprietary to BST – and it appeared to be a commonly used instrument in the financial market". The Transport Companies cite this as evidence of naivety.

83. To put it into context, the numbers of snowball swaps sold by banks to the public sector in Portugal was not great. Some fourteen in all were sold by BST.

84. Mr Evans who has had a long sales career said that he had never sold a snowball swap. The court finds (and it is not seriously in dispute) that these instruments were not in fact common in the swaps market as a whole.

85. They were presumably uncommon because of the risks involved. But the court does not think that this shows naivety on Mr Pinto's part. He was talking about proposals not sales.

86. There is some evidence that the fact that MdL entered into snowball swaps encouraged the other companies to do so.

87. What is clear is that given their indebtedness and funding needs, each of the finance departments had to have sufficient expertise to cope with considerable tasks of financial management, in relation to commercial bank debt, and other sources of finance. The evidence is that those tasks were rendered possible, or certainly easier, by the perception that ultimately the Portuguese State would stand behind them.

88. The evidence is that the companies were bombarded with unsolicited offers from international banks including BST to enter into swap transactions. But they themselves sometimes solicited such offers.

89. There is evidence that BST (and doubtless the other banks) were persistent in their sales pressure. One internal BST email refers to the necessity to keep the "siege very tight" on the finance officer concerned. Again, this does the bank no credit.

90. On balance however, the finance departments seem to have been able to deal with this high-pressure sales activity, choosing which proposals they regarded as most suitable for their needs. In assessing their overall understanding, as is done below, the fact they were dealing with other banks is relevant—the Transport Companies were not dealing with BST in isolation.

(iii) The MtMs

91. The MtMs as shown in the statements provided by BST to the Transport Companies are contained in agreed form in the Annex. The picture is not complete, because BST did not send statements from the time the swaps were entered into. It began to send them in 2008 (the exception being Carris 1 in respect of which the first statement was sent in 2007), and stopped sending them in 2013 after the Transport Companies ceased making payments.

92. The experts also agreed the MtMs at the time of inception and all were negative numbers:

Carris 1	(€2.5m)
Carris 2	(€7m)
STCP	(€1.5m)
MdL 1	Between (€24m) and (€12m)
MdL 2	Between (€15m) and (€9m)
MdL 3	Between (€2.4m) and (€0.9m)
MdL 4	(€9m)
MdP 1	Between (€15.3m) and (€11.6m)
MdP 2	Between (€10m) and (€6m)

93. It should be noted that, to the limited extent that BST statements are available that far back, the numbers differ, and are positive. This is a reflection of the fact that the calculation of the mark to market value of a swap involves a good measure of judgment.

94. Also, it is relevant that the first three MdL swaps were entered into to restructure existing swaps with BST, which already had negative MtMs.

95. The Transport Companies assert that they should have been provided with the MtMs at inception as a means of understanding the risks. They say that had this information been disclosed to them, they would have known that the swaps were not expected to reduce their interest expense over the lifetime of their loans and, therefore, that they were not appropriate for the purpose of reducing their borrowing costs.

96. However, their case did not appear to be supported by their expert Mr Harkins, who said in that regard that the MtM "doesn't tell you a lot", and the court does not accept such an assertion.

97. Further, the Transport Companies could have asked for MtMs from BST had they wanted them.

98. In fact, the companies did not show the "fair value" of the swaps in their accounts at this time. So far as the accounting treatment is concerned, the evidence is that MdL did not account for the value of the swaps in their annual accounts until sometime after 2007, from 2009 in the case of STCP, and sometime after 2009 in the case of Carris.

(iv) Metropolitano de Lisboa

99. The parties have agreed details of the swaps entered into by the Transport Companies, and as might be expected, MdL entered into much the greatest number.

100. Even allowing for restructurings, there were a considerable number of these swaps, entered into (as noted elsewhere in this judgment) with a wide variety of international banks. Only a small number were snowball swaps. Generally, however, it is not in dispute that MdL was very familiar with swaps as an instrument of financial management.

101. In support of their case that the Transport Companies did not understand the risk, it was submitted that Mr Evans had calculated that MdL 2 had a 50% chance of making a loss, so that Ms Antunes was wrong to suggest there was a "comfortable risk profile" in respect of this swap.

102. The court does not accept this. In fact, the agreement between the experts is that MdL 2 had a 46-50% probability of loss and a 50-64% probability of gain when entered into. (This was considerably lower than the other swaps. The experts agree that the swaps overall had a probability of 72% of providing a potential benefit to the Transport Companies over the life of the swaps.)

103. It is further to be noted that this swap was a restructuring, and the negative value of the original swap has to be taken into consideration. Nothing can be deduced from these facts as regards any lack of understanding on the part of MdL.

104. Ms Antunes' evidence is that BST's proposals did not include any forward or stress testing because they knew from their discussions that MdL was undertaking its own internal analysis.

(v) Metro do Porto

105. Twenty one swaps were entered into by MdP between August 2006 and June 2010, though some were restructurings.

106. The Transport Companies' case as to Mr Pinto's naivety, and the inadequacy of the "digicoupon" which he negotiated for the first swap is dealt with elsewhere.

107. It is said that though the swap was said to give MdP a risk-free gain figure of €5.3m, this was "peanuts" compared to the negative MtM. It is pointed out that on 30 May 2008, this was -€30.8m.

108. However, by this time, the financial crisis was underway. At inception, the experts agree that the MtM of this swap was negative between €15.3m and €11.6m.

109. By way of comparison, the experts agree that MdP 2 was negative at inception between €10m and €6m. As explained elsewhere, this swap had no lower barrier, and no loss is alleged in relation to it.

110. Mr Pinto also said in evidence that the expectation at the time of contracting the first MdP Swap was that "rates below 2% was possible, and it was expectable in scenarios of great retraction … but it was not our expectation that it could go for a long period of time".

111. This was fair evidence in the court's view. He accepted that rates might go below the barrier in extreme circumstances, as is obvious in a swap with a term of 16 years, albeit as he says, no-one expected this to happen in the way and for the period that it did.

(vi) Carris

112. The Transport Companies describe the stress testing carried out by Carris itself prior to entering into Carris 1 in November 2006 as "rudimentary".

113. The court accepts this, because the application of + 0.25% and - 0.25% shifts in forward rates, which seems to have been what was done, was clearly inadequate. (It is unclear why such low shifts were adopted.)

114. But the recommendation that went to the Board did not depend on what would happen if rates went outside the barriers. Rather, it depended on the view that "it does not seem credible that it [the 10-year CMS swap rate] can fall below 2.75%" and that "the existing scenarios for EURIBOR 6M do not point towards it being able to surpass 6%"—in other words, that rates would remain within the barriers.

115. This accorded with the consensus at the time as to rates which was reflected in forward interest rates. However, Ms Cabaço Antunes of Carris effectively accepted in her evidence that it was understood that rates might turn out differently to those predicted, as again is obvious in respect of a swap with a life of 18½ years.

116. The Transport Companies say that the recording of the call in which the first Carris swap was executed on its behalf by Professor Sousa Bentes does not show any great expertise on his part in snowball swaps, and the court accepts this.

117. On the other hand, as BST says, he cannot have thought that the risk attached to the spread was literally "null", and Ms Cabaço Antunes did not. His question about how BST made money from the transaction does not directly go to the risk issue. (The answer he was given was that it came from the options that are implicitly incorporated in the structure and which have value. This point is explained above.)

118. Carris 2 was structured differently in that the spread becomes payable if the 2-year EURIBOR CMS rate exceeds the 10-year EURIBOR CMS rate—i.e. the 10-year EURIBOR CMS rate is in effect the barrier of the 2-year EURIBOR CMS rate.

119. Like MdP 2, this structure has not behaved like the other swaps, because without a lower barrier, no spread has become payable and so only the fixed rate element of the pay leg is payable.

(vii) STCP

120. The STCP swap had a trade date of 2 November 2007. Société Générale had done a sensitivity analysis in relation to the transaction. It emailed Ms Antunes figures stating that in a "stress scenario you can lose up to 389,368,711 USD. Please confirm us your customer has received all this information".

121. In fact, it was not passed on to STCP, the BST response being, "What we can guarantee is that we are aware of the transaction we want to close".

122. No explanation was given by BST of what was an odd response, and the Transport Companies emphasised the Société Générale email in their oral closing submissions.

123. Ms Antunes said in her evidence that, since the swap was uncapped, depending on the stress scenario applied, any value can be achieved, however unlikely. She put it as much less than 1%.

124. There is logic in this answer, but the failure to pass the information on is nevertheless a matter of concern. The court states its conclusions as follows.

125. The Transport Companies do not suggest that there was any bad faith on the part of BST—this is cited as an example of the assertion that the Transport Companies did not understand the extent of the risk.

126. In that regard, it is striking how thorough the process was that led to STCP entering into the swap. The process lasted many months.

127. At a meeting on 27 February 2007, BST made a presentation to STCP including various stress testing scenarios of the proposed snowball structure, in one of which the upper barrier was breached and remained breached by 40 basis points for the majority of the swap's term. BST says that this showed interest in excess of 20% being payable by STCP, which is obviously very large.

128. In all, STCP received 32 proposals from 7 banks. According to BST, by 8 October 2007 it had a choice, from BST alone, of 6 different snowball swaps. Four banks were shortlisted by the company, their proposals including one other snowball swap proposed by another bank (Barclays).

129. These were the subject of a detailed internal analysis dated 30 October 2007 by the director with responsibility for finance, Mr Paulo Sá. There is no reason to doubt his competence. In the event, the BST proposal was the one adopted.

130. On balance, the court is satisfied that the Société Générale email does not affect the issues the court has to decide. It cannot reasonably be asserted that STCP was unable

to understand the transaction it entered into—and the example of the process is relevant to the other companies too.

131. Further:

(1) The potential loss of USD 389,368,711 cited in the Société Générale email is to be compared to the MtM at inception—the experts' agreed valuation of this swap is the smallest of the nine swaps at -€1.5m.

(2) Even BST's stress tested interest rates of 20% were far short of the mark—the rate payable as at 1 October 2015 is nearly double that at 36.743%, and this is because of the unforeseen effect on interest rates of the financial crisis.

(viii) The court's findings

132. The court finds that:

(1) The spread formula as set out in the confirmations is hard to understand when first read.

(2) But there is no dispute that it is straightforward once understood. It was the business of those in the finance departments of the Transport Companies to understand the spread formula, and there is no dispute that they did so. The court would not agree with the Transport Companies' submission that this case is concerned with "the most sophisticated and complex of structured products".

(3) As regards interest rate volatility, the court accepts that it is doubtful that the Transport Companies, or for that matter the bank, fully appreciated the sensitivity of the MtMs to such volatility as explained by Mr Harkins. (In closing, counsel for the Transport Companies said that the bank had not in fact fully understood the risks.)

(4) But it is not suggested that they were unaware of mark to market values, or that these would have to be settled on any restructuring. The MtMs were bound to reflect a trend in interest rates towards the barriers if that became in any way pronounced.

(5) It could not be supposed that swaps with these features would behave the same way as vanilla swaps, with their linear movements. It is the spread formula, with its amplification through leverage and its accumulation even where interest rates move back within the barriers, together with the long term nature of the instruments, which accounts for the very risky nature of these swaps. The negative effect of volatility on the MtMs well before interest rates breach the barrier is ultimately referable back to this.

(6) It is an understanding of the scale of the risks that is important, rather than how the risk plays out in particular ways.

133. The court does not accept the Transport Companies' case that further information should have been provided to inform them as to the risks. On the totality of the evidence, including its appraisal of the witnesses, it finds that:

(1) There cannot have been any real doubt on the part of those responsible within the Transport Companies for entering into the swaps about the scale of the risks that the swaps entailed.

(2) The background of the negotiations as set out above is relevant in this respect. As can be seen from the example of STCP, this was a thorough process, involving other banks as well as BST.

(3) The risk can now be seen in the light of subsequent events, but at the time the risk was seen as acceptable.

(4) Mr Evans' evidence was that the risk was evident from the terms of the swaps, and despite the submissions that have been made, the Transport Companies' witness evidence in effect confirmed this.

(5) The view of Mr Pinto of Metro Porto communicated internally at the time of BST's proposal for MdP 1 was that along with a "very attractive pick up"—in other words, the fixed rate payable by the company—the spread gave the proposed swap a "very, very aggressive risk profile".

(6) This was an entirely accurate assessment. There was no doubt in his mind, and there can have been no doubt in the minds of those responsible in the finance departments of the other Transport Companies, as to what the snowball structure involved.

(7) The *quid pro quo* for the "very, very aggressive risk" they assumed was the benefit of a very low fixed rate of interest while the barriers held good. They must have realised that the one was only possible because of the other, and this does not require any great degree of financial sophistication.

134. It is also relevant how Mr Pinto sought to deal with this risk. He asked BST to introduce a mitigator which would reduce the impact of the risk. In response, BST introduced a "digicoupon". This is the name given to a mechanism which reduces the spread by 0.5% for each fixing date on which the relevant interest rates come back within the barriers.

135. The Transport Companies say that the events of the last few years have shown that the digicoupon is useless in circumstances where there are prolonged periods of low or high interest rates which breach the barriers, i.e. in circumstances where the risks of the swap are most damaging.

136. However, that is to apply hindsight. The instance of the digicoupon tends to show that the risk was appreciated, but on the basis of macro-economic conditions as they were then:

(1) It is common ground that market consensus at the time of the swaps shown through e.g. forward rates predicted that rates would stay within the barriers.

(2) But both parties to the swap obviously appreciated that—under the conditions that then prevailed—interest rates could fluctuate in unpredicted ways, and

that a prediction through forward curves or otherwise was no more than a prediction.

(3) There was obviously a risk that interest rates would breach the upper or lower barrier, and might do so for substantial periods of time. But the expectation of both parties was that when rates returned to within the barriers, the mitigator would gradually bring payments down as it was intended to do.

(4) Further, as explained below, in the case of all the swaps, managing them would potentially include restructuring.

137. What none of these parties did and could appreciate was that as a result of the financial crisis interest rates would cease to behave in accordance with prevailing conditions. The parties did not and could not appreciate that as a result of the financial crisis, interest rates would behave in an unprecedented manner, and drop to near zero (as economists have traditionally described it, the "zero lower bound") and stay there. The court's findings as regards interest rates are set out in detail below.

The Transport Companies' purpose in entering into the swaps

138. The experts agree that the fixed rates payable by the Transport Companies are lower than the equivalent 'vanilla' swap which could have been obtained at the time the swaps were executed.

139. This is shown by the following figures:

Swap	*(Weighted average) Fixed rate*	*Comparable market swap rate achievable*	*Difference*
Carris 1	1.835%	3.88% - 3.94%	2.05% - 2.10%
Carris 2	2.95%	4.59% - 4.65%	1.64% - 1.70%
STCP 1	2.23%	4.66% - 4.73%	2.43% - 2.50%
MdL 1	2.18%	3.79% - 4.25%[4]	1.61% - 2.07%
MdL 2	2.74%	3.51% - 3.60%	0.77% - 0.86%
MdL 3	3.00%	4.65% - 4.70%	1.65% - 1.70%
MdL 4	1.69%	4.58% - 5.03%	2.89% - 3.34%
MdP 1	1.76%	4.76%[5]	3.00%
MdP 2	1.75%	4.82% - 4.88%	3.07% - 3.13%

140. Overall, the experts agree that the swaps had an approximately 72% chance of providing these potential benefits to the Transport Companies over the life of the swap. This appears from their joint memorandum:

> "We agree that, overall, the Swaps can be characterised as having a higher probability (approximately 72%, after adjusting for the mark to market position of prior interest rate derivatives) of providing a potential benefit, over the life of the

[4] The calculations relating to the MdL swaps incorporate the cost (or benefit) of terminating the existing MdL interest rate derivatives.
[5] MdP 1 paid a fixed rate of 4.76%.

> Swap (through the initial reduction in the interest rate payable and the potential for a continued low interest rate payable for the remainder of the term), than of providing a potential loss. Section 11 shows the probability of a gain and loss and the size of potential gains and losses for each of the Swaps."

141. At the same time, this saving was achieved by taking on a high degree of risk as a result of the effect of the leverage/accumulation in the spread formula when interest rates breached the barriers. For reasons set out elsewhere, this risk was understood by the parties.

142. The following findings are made as to the purpose of the Transport Companies in entering into the swaps:

    (1) The evidence clearly establishes that the purpose of the Transport Companies in entering into the swaps was to reduce the amount of interest they were paying on the underlying transactions.

    (2) The officers concerned had no intention of speculating, and that did not form part of their motive.

    (3) The transactions were seen at the time as sound management of the companies' extensive debt, this being a time when a very different attitude prevailed as regards such instruments than was the case after the financial crisis.

    (4) These savings were in the early years largely achieved.

<u>The nine swaps</u>

143. There is some evidence that the practice of reducing interest rates through the use of swaps by public sector companies had a modicum of official encouragement. This was by the Tribunal de Contas (Court of Auditors) in 2006/2007 in relation to the first MdP swap, and a 2008 report by the Portuguese Inspectorate General of Finance, in which it referred to the Carris swaps as an example of good management. This was reflected in the companies' accounts.

144. There is not enough evidence to justify findings by the court of any official "pressure" to enter into these swaps.

145. What this evidence importantly illustrates, however, is the economic climate at the time. Swaps were seen as useful financial instruments, and the Transport Companies were likely to be interested in such instruments because, as BST puts it, through a combination of insufficient State funding and an inability to raise ticket prices to cover costs, they depended on large and increasing amounts of debt to fund their operations and investments.

146. The negotiation of the swaps is set out in the agreed chronologies, and the court need not set out the details which do not affect the issues for determination. There are a few points to highlight.

147. The trade dates for the swaps fall between 6 June 2005 (MdL1) and 2 November 2007 (STCP). As shown above, there were generally a number of banks bidding for the contracts, and typically the negotiation process took some months.

148. BST typically offered the client a number of prospective structures, with different risk profiles, of which the snowball structure was one. Some of the swaps were restructurings of earlier swaps.

149. The key facts relating to each swap are set out in agreed form in the Annex. Each swap was transacted pursuant to the terms of an ISDA[6] Master Agreement the dates of which are also set out in the Annex.

150. Each of the nine swaps in issue has broad similarities of structure, but there are a number of differences in the terms. In tabular form, their basic characteristics are as follows:

Swap and trade date	Term of swap	Notional amount	Receive leg	Pay leg – fixed rate	Pay leg - spread
Carris 1 10/11/06	15/09/2006 to 15/03/2019	€90,000,000 amortising	6-month EURIBOR	1.835%	Upper Barrier: 6% (6-month EURIBOR) Lower Barrier: 2.75% (10Y EURIBOR CMS) Leverage: 3.5x (Payable from 17 December 2007, reset to zero 15 December 2011)
Carris 2 05/06/07	27/03/2007 to 27/03/2016	€100,000,000 amortising	6-month EURIBOR	2.720% (until 27/03/2008) 3.150% (until 27/03/2009) 2.950% (until maturity)	Difference between 2Y EURIBOR CMS IA and 10Y EURIBOR CMS IA Leverage: 2.5x (Payable from 27 June 2009)
MdL 1 06/06/05	23/09/2005 to 23/09/2022	€99,240,295 amortising	6-month EURIBOR minus 0.71%	1.25% (until 23/09/2009) 2.55% (until maturity)	Upper Barrier: 8% (3-month EURIBOR) Lower Barrier: 1.5% (3-month USD LIBOR) Leverage: 0.8965x (Payable from 23 March 2006)
MdL 2 22/09/05	01/07/2005 to 01/01/2019	€92,497,212 amortising	6-month EURIBOR minus 0.71%	1.44% (until 01/01/2009) 3.67% (until maturity)	Upper Barrier: 8% (3-month EURIBOR) Lower Barrier: 1.5% (3-month USD LIBOR) Leverage: 2x on 3-month EURIBOR exposure (Payable from 1 October 2005)
MdL 3 30/03/06	15/03/2006 to 15/09/2019	€78,560,669 amortising	3-month EURIBOR	2.75% (until 15/09/2008) 3.12% (until maturity)	Upper Barrier: 6.75% (3-month EURIBOR) Lower Barrier: 2.75% (10Y EURIBOR CMS) (Payable from 15 June 2006)
MdL 4	15/03/2007	Fluctuates,	3-month	2.00% (until	Upper Barrier:

[6] International Swaps and Derivatives Association.

31/05/07	to 15/06/2022	maximum of €64,726,245	EURIBOR	15/03/2010) 1.65% (until maturity)	6% (3-month EURIBOR) Lower Barrier: 2% (3-month EURIBOR) Leverage: 2.25x (Payable from 15 June 2010)
MdP 1 11/01/07	13/12/2006 to 13/12/2022	€89,083,545 amortising	4.76%	1.76%	Upper Barrier: 6% (3-month EURIBOR) Lower Barrier: 2% (3-month EURIBOR) Leverage: 2x (Payable from 13 March 2009)
MdP 2 13/08/07	17/09/2007 to 15/09/2027	€60,000,000 amortising	3-month EURIBOR	1.75%	Upper Barrier: 6.5% (3-month EURIBOR) Leverage: 1.5x (Payable from 15 December 2011)
STCP 02/11/07	05/12/2007 to 05/06/2022	€25,000,000	6-month EURIBOR	2.23%	Upper Barrier: 6% (3-month EURIBOR) Lower Barrier: 2% (3-month EURIBOR) Leverage: 1.25x (Payable from 5 March 2011)

151. It is to be noted that:

(1) The terms of the swaps varied between 9 and just under 20 years.

(2) The "notional amount" on which interest is calculated matches the amount of an underlying indebtedness of the relevant transport company (MdL 4 relates to part of a restructured loan). The details of the underlying agreements are set out in the Annex to the judgment so far as necessary.

(3) The notional amounts amortise over the term of the swaps (though in differing ways[7]). This has the effect of reducing the amounts payable. No swap wholly amortises (and the STCP swap does not amortise at all).

(4) The "receive leg" is the amount receivable by the Transport Company from BST, and is a floating EURIBOR rate[8]. This rate dropped to near zero in 2009, as discussed further below.

(5) The "pay leg" payable by the Transport Company to BST comprises a fixed rate component[9] and a "spread" component. The fixed rate was appreciably lower than the rates that would otherwise have been payable on the underlying indebtedness at the time the swaps were entered into (see above).

(6) The fixed rate has added to it a "spread" potentially payable after an initial "holiday" of between 6 months and 4 years.

[7] The notional amount of MdL 4 amortises unusually in that it starts at €4.28m, then increases to a peak of €64.7m, and then decreases to €8.3m.
[8] Except in the case of MdP 1 where BST pays a fixed rate of 4.76%. This is a restructuring of a fixed rate payment obligation of MdP pursuant to a fixed-for-floating swap with Banco Commercial Português
[9] Which varies slightly over the life of some of the swaps.

(7) The spread is an additional interest rate calculated by reference to upper and lower[10] "barriers" as shown in the table.

(8) These barriers vary from 8% to 1.5%, depending on the terms of the individual swap as shown in the table. If the relevant reference interest rate remains within the barriers, no spread is payable.

(9) If the relevant reference interest rate or rates exceed either the upper barrier or the lower barrier (or, in some cases, both), the Transport Companies are required to pay BST by way of spread the difference between the reference interest rate and the barrier which has been breached.

(10) For example, the MdL 3 swap has a lower barrier of 2.75% by reference to the 10-year EURIBOR CMS[11] rate. If that rate falls to 2.25%, MdL is required to pay BST (in addition to the fixed rate) a 0.5% spread (being the difference between 2.75% and 2.25%).

(11) Under the "snowball" effect, if the relevant reference interest rate continues to exceed a barrier on subsequent fixing dates, the spread for the current period is added to the spread for the previous period, i.e. it is cumulative.

(12) Taking the example of the MdL 3 swap again, if the 10-year EURIBOR CMS rate remains at 2.25% on six consecutive fixing dates, the cumulative spread on the second fixing date will be 1%, on the third fixing date will be 1.5%, and on the sixth fixing date will be 3%.

(13) The MdL 3 example is the only swap where there is no leverage.

(14) The others are subject to leverage[12] as shown in the table. The operation of leverage is explained in the Annex. It operates as a multiplying factor on the spread in an amount which varies from swap to swap.

(15) Once a spread has accumulated, as a general rule it remains payable on all subsequent interest payment dates, even if interest rates move back within the barriers.

(16) In the case of some of the swaps there are potentially significant "mitigating" features[13]:

a) Carris 1 contains a "reset" which provided for the spread to be reset to zero in September 2011 after which it began to accumulate again.

b) The STCP, MdL 4 and MdP 1 swaps contain a "digicoupon" which reduces the spread by 0.5% for each fixing date on which the relevant interest rates fall back within the barriers[14].

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[10] With two exceptions: MdP 2 has only an upper barrier, and thus has escaped the effect of near zero interest rates. In the case of Carris 2, the result is similar in that the spread becomes payable if the 2-year EURIBOR CMS rate exceeds the 10-year EURIBOR CMS rate, which has not happened: i.e. the 10-year EURIBOR CMS rate is in effect the barrier of the 2-year EURIBOR CMS rate.

[11] Constant Maturity Swap rate.

[12] In the case of MdL 1, the formula operates to decelerate change in the coupon once the barrier is breached.

[13] Explained further in the Annex and elsewhere in this judgment.

c) MdP 2 contains a "cushion", which operates to reduce any accumulated spread by 0.3% on fixing dates when the reference rate moves back below the barrier (there only being an upper barrier in its case).

(17) As is the invariable practice as regards swaps, payments are made on a net basis.

The back-to-back contracts

152. BST hedged its exposures under the swaps via back-to-back contracts on ISDA terms governed by English law. The back-to-back contracts were entered into between BST and BSNP under an ISDA Master Agreement and Schedule dated 17 June 1998, and were in turn subject to back-to-back contracts between BSNP and Santander Spain under an ISDA Master Agreement and Schedule dated 3 April 1996. These contracts were governed by English law. These facts are agreed between the parties.

153. Following the merger of BST and BSNP in 2009, a novation agreement was concluded under which all agreements between BSNP and Santander Spain, including the back-to-back swaps, were novated to BST.

154. BST's case is that under these back-to-back swaps, it was – and remains – exposed to the same risks as those to which the Transport Companies are exposed under the swaps: "Unlike the TCs, however, BST has complied with its contractual obligations and continues to pay the sums due under the back-to-back swaps. BST is currently, therefore, very substantially out of pocket, and if the TCs were to succeed in their defences or counterclaims would suffer further losses amounting to its uncovered liabilities under the back-to-back swaps. None of this has ever been challenged by the TCs".

The selling of snowball swaps is stopped by Santander Spain

155. In June 2008, Santander Spain effectively withdrew its approval for the sale of further snowball swaps. By this time, BST had sold a total of fourteen snowball swaps, all to public sector companies.

156. Ms Antunes' oral evidence was that one of the reasons for Santander Spain withdrawing approval was because the existing transactions on BST's balance sheet were "consuming the credit lines with these companies". BST says that this was the only reason, but the court does not accept that.

157. Ms Antunes said that there were discussions about the "suitability of the derivatives", and as the Transport Companies say, given the concerns expressed by Santander Spain about these transactions in the past (see above), it is likely that suitability considerations were a key factor in Santander's decision to withdraw its approval.

158. By this time, though interest rates had not yet plunged, the financial crisis was well underway, and suitability was doubtless seen in the very different atmosphere from that prevailing when these swaps were sold.

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[14] Where, as in this case, interest rates have not moved back within the lower barrier, the digicoupon has not taken effect.

Dynamic management and restructuring proposals

159. BST's case is that though these swaps entailed a large risk, nothing required the Transport Companies to hold on to the swaps as they did, at least in their initial form. It was open to them to adopt, and implement, a dynamic strategy for avoiding or mitigating the losses under the swaps by closing or restructuring them. The importance of such an approach was either already known to them, or made clear to them from the outset.

160. Essentially, BST seeks to pass responsibility for losses that have accrued on these instruments back to the Transport Companies, on the basis that their predicament "is thus at least in part of their own making".

161. The Transport Companies respond that the phrase "dynamic management" is a "fantasy", because the complexity of the situation was such that BST itself lacked the capacity effectively to manage these swaps, if indeed that could be done within acceptable parameters.

162. In the court's view, when these swap transactions were entered into, all of which were long-term, there must have been a reasonable expectation on both sides that the Transport Companies would seek to manage the swaps, as part of the management of their debt:

(1) That would potentially include restructuring which, the evidence shows, is a normal consideration in the case of swaps when the instruments are out of the money, and some of these swaps actually came out of restructurings.

(2) The Transport Companies themselves accept that they were aware that they needed to monitor the risks of the swaps.

163. However, BST was also expected to play a significant part in this process. Ms Antunes accepted that "as a selling point we had told the clients that we would propose, according to our capabilities, restructuring deals".

164. Presumably in the light of the relationship that then existed between the public sector entities such as the Transport Companies and the bank, and the complex nature of the swaps, in the summer of 2007 BST received express instructions from Santander Spain to play an active role in that regard.

165. This appears from the Structured Derivatives Operative that was put in place after the meeting in Madrid following the New Products Committee report by BST of 20 June 2007 as described above.

166. It states among other things that:

> "A dynamic management will be ensured for each closed operation, over its lifetime, in order to make available to the Client, alternative options to the maintenance of the product, namely whenever this last could be less favourable, either because it would worsen the losses, or not allow him to achieve significant capital gains".

167. The document emphasises the desire of Santander Spain to see that the client received as much support as possible in connection with structured derivatives that had been entered into and any future transactions. There is no reason to suppose that BST took any different view, but in practice its ability to do so was constrained.

168. In view of the deteriorating financial position globally, it seems clear that from early 2008 people began to appreciate the depth of the problems. The mark to market values (MtMs) of the swaps, which BST began to send to the Transport Companies in 2008, clearly reflect concerns as to the position.

169. By way of example, the earliest dates on which the Transport Companies were sent statements showing that the swaps had a negative MtM of more than €5m were:

Swap	MtM date	Date of statement	MtM
Carris 1	30 June 2008	3 July 2008	-€11,904,066
Carris 2	30 June 2008	3 July 2008	-€20,343,074
MdL 1	30 December 2005[15]	13 March 2008	-€9,749,346
MdL 2	30 September 2008	9 October 2008	-€10,640,359
MdL 3	31 December 2008	5 January 2009	-€8,896,364
MdL 4	31 December 2007	13 March 2008	-€31,175,312
MdP 1	30 May 2008	11 June 2008	-€30,840,916
MdP 2	30 May 2008	11 June 2008	-€7,560,256
STCP	30 June 2008	2 July 2008	-€10,010,254

170. Almost all of these statements were sent in 2008, the MtMs of the swaps being firmly in negative territory.

171. The MtMs are highly relevant to the dynamic management/restructuring issue because the cancellation of a swap would involve the company paying the MtM, and its value would be reflected in a restructuring short of cancellation.

172. The MtMs fluctuated, but the general picture is of one of deterioration during 2009, in some cases very steeply. This deterioration can be seen as particularly pronounced in the case of swaps where statements are available pre-2008.

173. Also during 2009, the amounts received by the Transport Companies from BST were for the first time less than the amounts payable by BST.

174. By 2013, when statements ceased to be sent, all the MtMs had declined greatly, and in some cases radically. (The exceptions are Carris 2, where the spread was calculated on a different basis, and MdP 2, which had an upper but no lower barrier: see above.)

[15] This MtM dates from the year the swap was entered into. By way of comparison, the MtM in the statement dated for year end 2008 was – €64,953,441.

175. Although in these proceedings it has criticised the Transport Companies for not doing more to manage the swaps by way of restructuring, BST was itself subject to criticism for the same reason.

176. On 19 December 2008, Mr Veiga Anjos, who from 2006 was BST's Head of Corporate and Investment Banking Division, emailed Ms Antunes saying:

> "I remind you that during the purchase of these products we always told the clients that we would follow the structures so as to propose alternatives according to the market evolution. It is natural that the client should feel very disappointed with our inability to suggest alternatives at this point."

177. Notwithstanding, BST says that it is common ground between the transaction experts that the Transport Companies could at any time have cancelled the swaps by paying the MtM, subject to any execution costs, and that they could also have sought to restructure or offset the termination costs by entering into a further derivative either with BST or a suitable alternative bank.

178. However, the question is as to how realistic this was, given the costs involved, and the sensitivity of public sector bodies to agreeing new deals with high interest rates when market rates were so low.

179. BST relies on settlements reached with other banks:

(1) As to MdL, BST says that during 2013 the accounts show that "the company settled 34 swap contracts by paying the total sum of €490,851,289. These included snowball structures with BNP Paribas, JP Morgan and Deutsche Bank, and other swaps in respect of which MdL was able to pay as much as €84.1 million. It must follow, therefore, that had MdL been willing to restructure the Swaps, it could have obtained the necessary funds".

(2) However, it does not follow in the court's view that MdL could have obtained the necessary funds, and as the Transport Companies say, this submission raises issues relating to without prejudice negotiations between themselves and BST and between themselves and other banks which the court is not able to go into.

180. There is also the question of what BST itself was suggesting:

(1) After the onset of the crisis in mid-2007, it is probable that the period prior to September 2008 when the crisis erupted with the failure of Lehman Brothers, was (with hindsight) the time when the swaps could have been unwound at least cost.

(2) In June 2008, however, BST sent what are reasonably described as "reassuring" emails to the Transport Companies, pointing out that "the barriers are still a long way from being breached".

(3) As the Transport Companies say, and as is explained above, this was not the only risk, since volatility affected the MtMs (although by now, each of the

Transport Companies was receiving regular statements, and could see this for themselves).

(4) Nevertheless, as they say, BST was essentially advocating maintaining the status quo, and not restructuring. Perhaps, as BST says, it was not formally advising this course, but that is unlikely to have affected the impression that these emails gave.

181. By mid-2009, interest rates had fallen below the lower barrier of the seven swaps that had one. Over the next few years, there was much communication between BST and the Transport Companies, including various proposals by BST for restructuring. Neither of the parties has gone into the detail. None of the proposals came to anything.

182. Mr Harkins, who reviewed them, is of the opinion that the Transport Companies did not act unreasonably in not accepting any of the proposals since he says that they simply shifted the risk profiles of the swaps towards greater risks with lower probabilities. Insofar as they involved the full termination of the swaps, this involved crystallising the mark to market value of the swaps, and also, in some instances, significant premia for the removal of the risks.

183. Mr Evans took the view that it was not his task to review the restructuring proposals and did not have sufficient information to be able to evaluate them. In the context of BST's submissions, that was not a convincing position to take.

184. The result is that Mr Harkins' evidence in this regard was unchallenged, and the court accepts it. It is consistent with the rest of the evidence as to the effect of continuing near-zero interest rates on these long-term swaps.

185. In particular, it is consistent with views expressed outside the litigation by BST itself.

186. In an email of 28 October 2011 from Ms Antunes to someone in Santander's press department in Madrid, she said:

> "<u>Performance of Banco Santander</u>
>
> Banco Santander has contracted this type of long-term derivatives during the period 2005-2007. We hold in our portfolio 10 Previous derivatives (with cumulative memory effect). Since then we have been acting with companies proposing restructuration's with the aim of reducing leverage.
>
> With rising volatility and falling interest rates, the cost of restructuring through deleveraging implied increasing running financial costs.
>
> In a risk / cost analysis that companies have carried out, the conclusion has always been that restructuring was not worthwhile: by that time there was no expectation that interest rates could remain low so long. Even in the 1st half of 2011 the consensus was that in 2012 the short-term rates would

> gradually rise, which meant that it was not worthwhile to assume the high cost of restructuring (very much penalized by higher volatility).
>
> In addition, the sharp rise in volatility increases the difference between MtM and the value of the expected future cash flows, which makes it even more difficult the decision to lock-in the MtM."

187. In a presentation to the Portuguese Secretary of State of Treasury and Finance in January 2012, she said:

> "Around the end of 2008, after Lehman went bankrupt, the world economic situation is reverted significantly. Just 4 months after the reference rate had risen to 4.25%, the European Central Bank (ECB) initiates the fastest and most extensive cycle of interest rate cuts. In less than 8 months, the European Central Bank cuts 325bps, leaving its reference rate at a historical minimum of 1%. The implicit volatility also set off a sharp rise process, rapidly reaching the historical maximum.
>
> The current crisis, which clearly extends beyond the initial expectations, led to a strong change in the interest rate time structure as well as in the implicit volatilities. The interest rates (both Euros and Dollars) recently reached historical minimums in all maturities.
>
> There have been 2 main constraints to the restructuring of these derivatives:
>
> - Differential of the derivative's market value and the expectation of future flows taking into account the market forward interest rates (increase in volatility);
>
> - Asymmetry between the expectations of interest rate evolution on behalf of the economic agents and the reality of the extension of the crisis scenario (interest rates remaining extremely low)."

188. In cross-examination, Ms Antunes suggested that these documents reflected "the bank's ex-post interpretation of why the companies have opted not to restructure". The court does not accept that. There is no reason to suppose that it does not show what BST thought at the time.

189. The court:

(1) accepts that BST tried to come up with restructuring solutions, and that (as it put it) there is a difference between lacking the ability to restructure and objecting to the expense;

(2) broadly accepts the Transport Companies' submission that attempts to manage the swaps were ultimately unsuccessful because the eruption of the financial crisis in September 2008 "took everyone by surprise", and (as they put it) for a long time it was unclear whether it was in their interests to terminate or restructure the swaps, or to wait; by the time the position became clear, the swaps' MtMs were in the tens or hundreds of millions;

(3) finds in these circumstances that the Transport Companies acted not unreasonably in not terminating or restructuring the swaps within this time period.

Payment ceases

190. From about late 2011, the practical responsibility for dealing with the swaps passed to the IGCP (the *Agência de Gestão da Tesouraria e da Dívida Pública*, the Agency for the Management of the Treasury and Public Debt), the public body which since 2012 has managed and coordinated the funding and debt of public sector bodies in Portugal.

191. BST says that at a meeting with the Government on 6 March 2013, it was informed for the first time that the State did not intend to make any further payments under the swaps because it considered the derivatives to be speculative and void. No payments have been made since September 2013.

The Parliamentary Committee of Inquiry

192. The matters giving rise to these proceedings have been the subject of concern and controversy in Portugal.

193. The Transport Companies were not isolated among Portuguese public sector companies in their use of swaps.

194. In 2013, the Portuguese Parliament ordered that an inquiry be held known formally as "The Parliamentary Inquiry Committee on the Signing of Financial Risk Management Agreements (or "swaps") by Public Sector Companies":

(1) The Parliamentary Inquiry analysed a total of 103 swap transactions, entered into by a total of eight public sector companies with a number of banks including BST and with a combined estimated negative mark-to-market value at the time of €3.04 billion.

(2) In the course of forty-two hearings, evidence was heard from representatives of the public companies, national and international banks, the Portuguese Government and various professional advisers. As noted above, BST has referred to some of this evidence during the trial.

195. The Parliamentary Inquiry culminated in the publication of a lengthy final report in early 2014. The court has seen the conclusions, and both sides have provided summaries of the rest of the report.

196. The court has studied this material carefully, and found it invaluable in obtaining a perspective on the situation. The Inquiry was not, however, concerned with the legal questions which the court has had to address in this judgment. It is sufficient to say

that the Inquiry expressed grave concern about the circumstances that led to such a serious situation arising, and made recommendations to avoid a recurrence in the future.

PART C: CHARACTERISATION AND THE SPECULATION ARGUMENT

Introduction: the parties' cases

197. It is in dispute whether these swaps were proper instruments of financial management, as BST says, or are to be treated as speculative as in a bet, as the Transport Companies say.

198. It is also in dispute whether this issue has any relevance to the specific issues the court has to decide.

199. The Transport Companies' case is that they took on the risk of paying the snowball spreads in return for obtaining lower fixed rates of interest payable under the swaps than the fixed rates that would have been payable under plain vanilla swaps. If interest rates stayed within the barriers the bet was a good one, if interest rates went outside of the barriers, the bet was a bad one. The swaps involve speculation in future interest rates with the object of making a profit in order to reduce borrowing costs. The swaps yielded a positive return, as long as the interest rates stayed within the barriers, and that, in turn, was the difference between the fixed interest rates that the Transport Companies paid, and the floating rate that BST paid, but as soon as interest rates moved towards the barriers, in either direction, they were exposed to rising mark to market values and increased volatility, and when the interest rates moved outside the barriers, they were exposed to rising interest rates, whether the reference rates rose or fell.

200. The Transport Companies say that their case that the swaps are not effective risk management instruments, and are to be characterised as speculative, is relevant to the capacity issue, whether the swaps are 'games of chance', and whether having regard to BST's duties under the Securities Code the instruments ought ever to have been presented to the Transport Companies.

201. BST's case is that the swaps cannot be labelled as 'speculative' in any relevant sense, whether by reference to English law, Portuguese law or the views of the experts in swaps. The contention that 'speculative' in the relevant sense means only "not effective risk management instruments", and the contention that if the swaps are 'speculative' in this sense then that is all the Transport Companies need establish in order to succeed on the capacity, game of chance and Securities Code issues, is neither their pleaded case, nor supported by the evidence.

202. BST says that none of the Portuguese law tests involves an assessment of whether the swaps were 'speculative' in any sense.

The expert witnesses

203. The transaction experts were Mr Harkins for the Transport Companies, and Mr Evans for BST. Mr Evans' experience is primarily in sales, whereas Mr Harkins is an analyst.

204. BST criticises Mr Harkins, asserting that he had very limited experience in the use of swaps; was unable to deal satisfactorily with relatively simple applications of his own, personal, definition of 'speculation'; unduly narrowed the matters on which he gave evidence, for reasons he could not sensibly explain; his definition of 'speculation' – which was central to his analysis – failed to acknowledge or reflect either the lack of any industry-standard definition, or the range of opinions which might be expressed on the subject; in addition to relying upon a purely personal definition, Mr Harkins' view on what constituted speculation was both inconsistent and extreme. He proceeded, BST says, with an unbalanced presentation of the swaps, his analysis focusing almost exclusively on the risks run by the Transport Companies, and in particular on the most extreme risks.

205. The Transport Companies respond that many of BST's criticisms ignore the detailed analysis in Mr Harkins' second report. He accepted in his evidence that hedging and speculation are in a spectrum of risk, and so far as he narrowed matters, he was entitled to do so on the basis of BST's own evidence and other material, and he focussed on risks because that is central to the case. His cross-examination barely touched on the substance of his reports, presumably because BST had no grounds for challenging the substance of his evidence.

206. The court's view is as follows:

(1) Mr Harkins made a mistake in his report on a set of calculations, and though he promptly corrected it when it was put to him in cross-examination, this is a relevant consideration on the risk issue (see below).

(2) More broadly, though he was not as fluent a witness as Mr Evans, the criticisms made by BST are not justified. He was conscientious, and his evidence was of value in the matters it covered.

(3) In particular, he had analytical skills which Mr Evans did not have, but conversely Mr Evans had long sales experience which Mr Harkins lacked. Both are potentially relevant. So far as anything turns on their evidence, the court makes clear in the judgment whose evidence it has accepted on particular points.

<u>The Transport Companies' first question—are the swaps interest rate risk management instruments, and/or instruments for the reduction of borrowing costs?</u>

207. The Transport Companies approach the issue by asking two questions. The first is whether the swaps are interest rate risk management instruments, and/or instruments for the reduction of borrowing costs.

208. The parties disagree on the answer to this question, the Transport Companies saying no, BST saying yes.

209. The Transport Companies say that if the swaps were not properly capable of fulfilling either function, it follows that they are not to be properly characterised as instruments of financial management for the Transport Companies.

210. The Transport Companies say in summary that:

(1) When assessing the ability of any transaction or instrument to fulfil a particular purpose, one cannot take into account the potential benefits of that transaction or instrument without taking into account the potential detriment.

(2) Mr Evans' conclusion about the swaps' ability to meet the Transport Companies' objectives only holds true if one ignores the spread formula.

(3) The analysis of the PFEs (potential future exposure) and the MtM distributions showed that, rather than managing or eliminating the Transport Companies' interest rate risk, the swaps exposed them to significantly greater interest rate risks.

(4) The reason the Transport Companies chose to enter into such high risk instruments is that the Transport Companies did not have a proper appreciation of the risks of these instruments.

(5) None of the information available to the Transport Companies gave them any indication of the probabilities of the barriers of the swaps being breached.

(6) The purpose of entering the swaps was to benefit from reduced interest rates, and when the swaps' MtMs collapsed in 2008, the Transport Companies were still getting reduced interest rates. At that point in time, they had a choice between paying substantial termination costs (a difficult choice for publicly owned companies with limited financial resources) and remaining in transactions which appeared to be serving their intended purposes.

(7) Since the swaps did not reduce or manage the Transport Companies' exposure to interest rate risks, in fact increased the risks, the only issue is whether they are properly instruments for reducing costs.

(8) The answer to this is "no", because under these instruments there could be no such reduction of costs without the assumption of the risk of increasing costs if the reference rates went outside the barrier (whether the rates went up or down). The consequence is that, even in a situation of falling interest rates the Transport Companies were exposed to the risk of increasing costs. That risk was inherent in these instruments.

(9) The fact that the risk could only be managed by exiting the instruments before the barriers were exceeded illustrates that they were not appropriate for this task. In fact, the management of these instruments by "technically bankrupt" public service companies was not a task they could ever have been expected to perform.

(10) Reliance is placed on the evidence of Mr Harkins.

(11) In summary they say that the swaps:

a) are not hedges and they do not reduce or manage interest rate risk exposure: rather, they expose the Transport Companies to greater risks than those of the underlying finance agreements.

b) are only capable of reducing borrowing costs in certain, restricted conditions: the fact of the matter is that they expose the Transport Companies to the risk of much greater borrowing costs than would otherwise have been payable under the underlying finance agreements.

211. Many of the specific points raised here are covered elsewhere in the judgment:

(1) It is common ground that in assessing the ability of an instrument to fulfil a purpose, along with the potential benefits, the potential detriment has to be taken into account.

(2) The court disagrees that Mr Evans' conclusion about the swaps' ability to meet the Transport Companies' objectives only holds true if one ignores the spread formula; he did not accept this; there is a question as to the benefits of lower interest rates as against the extent of the risk inherent in the spread formula, but this is a question as to whether the price was too high.

(3) It is right that the swaps were very risky, but as against that rates were expected to stay within the barrier, and the risk was seen as a reasonable one to incur at the time.

(4) The court disagrees as to the Transport Companies' understanding of the risks for reasons stated elsewhere.

(5) As to (5), the Transport Companies knew that rates could breach the barriers, and there is no evidence that provision of the kind of so-called "Monte Carlo" pricing methodology used by the experts would have affected their decision.

(6) The court agrees as to (6) which is a factual matter, and as to (9) refers to the discussion elsewhere as to possible restructuring after the financial crisis; but these findings in the Transport Companies' favour do not affect the issue under consideration.

212. An aspect of this dispute is whether the swaps can be characterised as hedges.

213. BST says that the swaps contained "elements of hedging". This is on the basis that only the fixed rate was payable so long as interest rates remained within the barriers.

214. However, in evidence BST's witness Ms Antunes accepted that these swaps were not hedges. She said that they were financial management, not hedging, tools.

215. But this issue is of limited significance, because the experts agree that hedging is only one of a number of purposes of swaps.

216. The experts agree in the joint memorandum that there can be many purposes for an interest rate swap:

> "The economic objectives of general users of interest rate derivatives may include (but are not limited to): reducing or mitigating their interest rate risks arising from assets and/or liabilities; achieving Key Performance Indicators, for example net interest cover; improving their earnings and profitability by

> optimising or managing the risks of either assets or liabilities or both; hedging specific transactions or exposures; improving their cash flows by reducing interest expense, increasing income, or shifting the timing in which income or expense cash flows occur; and/or reducing operational costs related to core and non-core activities."

217. Further, as BST says, the fact that a swap is not a hedge does not mean that it is necessarily speculative. This is a point which is developed below.

218. The Transport Companies argue that the swaps did not reduce or manage their exposure to interest rate risks, and so cannot be interest rate risk management instruments.

219. However, as BST says:

 (1) the swaps were sought and concluded by the Transport Companies as a means of managing and, it was hoped, reducing their interest rate liabilities as much as possible in return for taking on what they considered to be an acceptable level of risk;

 (2) the swaps did in fact reduce their interest rate liabilities until 2009 by which time the financial crisis had erupted.

220. The Transport Companies argue that the risk taken on was wholly inappropriate compared to the benefits, particularly given their status as public companies, and because the risk was so great, and was present from inception, the swaps increased risk rather than decreasing it, and so were not tools of financial management.

221. However, the court accepts BST's case in this respect, finding that:

 (1) The Transport Companies understood the risks of the swaps.

 (2) It was ultimately a matter for them whether those risks were acceptable.

 (3) They were trying to bring down borrowing/financing costs, and did not intend to speculate.

 (4) The fact that the swaps were very risky does not mean that they cannot be seen as managing interest rates, and they did in fact bring rates down until conditions became adverse.

 (5) Alternatively, they did in fact reduce borrowing/financing costs until conditions became adverse.

 (6) Though it is right that the risk of increasing costs was assumed if the reference rates went outside the barrier whether the rates went up or down[16], that was the price of getting lower rates earlier.

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[16] Other than in the case of MdP 2 and Carris 2.

(7) Mr Harkins in his analysis tended to focus on the most extreme risks inherent in the swaps.

(8) Though he corrected the mistake, in the context of probability of loss, the worst outcome he calculated was in fact not 500 out of 10,000, as he indicated in his report, but was 1 out of 10,000.

(9) So far as it is a matter of expert evidence, the court prefers that of Mr Evans on this issue.

(10) The court finds that the swaps were interest rate risk management instruments, and/or instruments for the reduction of borrowing costs, and/or instruments of financial management.

(11) Each of them were instruments which managed the companies' debt.

The Transport Companies' second question—are the swaps speculative instruments?

222. The second question is whether the swaps are properly characterised as speculative instruments.

223. This is, as the Transport Companies put it, "effectively a 'belt and braces' argument", which is understood to mean that it is not an essential part of their case.

224. Given the court's findings on the first question, the second question does not strictly arise, but the point has been argued and the arguments will be briefly considered.

225. The question whether a transaction, or a financial instrument, or other financial dealing is "speculative", is one which often arises. For example, as explained above, Santander Spain told BST in Portugal to make sure that the purpose of these public sector clients was not to speculate but to manage their financial costs. It is a useful term, and one which conveys a particular message. However, at least according to the evidence in this case, there is no standard market definition, though for particular purposes there may be a relevant legal definition.

226. There were a number of examples of such a legal definition given at trial:

(1) The US Commodity Futures Trading Commission (CFTC) which now has regulatory oversight of the swaps market, defines a speculator as "a trader who does not hedge, but who trades with the objective of achieving profits through the successful anticipation of price movements."

(2) The evidence of Dutch law accepted by the court in *Credit Suisse International v Stichting Vestia Groep* [2014] EWHC 3103 (Comm) was that Vestia, which is a Dutch social housing association, had capacity only to conclude swaps which were "properly to be regarded as 'hedging instruments'" (at [219]). The experts agreed that this meant "the activity that an end-user counterparty undertakes to reduce its exposure to market risks" (at [225]).

(3) As is relevant to the "game of chance" issue in this case, the Supreme Court of Portugal's decision of 11 February 2015 (309/11.8TVLSB.L1.S1) as to the

applicability of the "gaming" provisions in the Civil Code, draws a distinction between a speculator and a gambler (as noted below the Transport Companies do not agree with its analysis).

(4) In *Hazell v Hammersmith and Fulham L.B.C.* [1992] 2 AC 1, it was held that English local authorities did not have capacity to enter into interest rate swaps, the court applying the relevant provisions of UK statutory law (since repealed as stated below).

227. There is a more general discussion of the issue in a well-known international dispute between the Ceylon Petroleum Corporation and various banks. An arbitration between Citibank and the Ceylon Petroleum Corporation concerned CPC's capacity to enter into instruments which had some structural similarities to those in the present case, though in the oil market.

228. At ¶5.47 of the arbitration award published on 31 July 2011, a passage on which the Transport Companies rely, the Tribunal distinguishes between hedging and speculation, stating that, "The use of derivative instruments to raise money in order to reduce the effect of already high prices is necessarily speculation, and not risk management".

229. However, this approach has not been adopted in the English courts. A major part of the reason is the difficulty of drawing distinctions between the various activities of speculation, hedging, financial management and similar in the absence of an applicable definition, making it difficult to determine—either before or after the transaction is entered into— whether it is within an entity's capacity or not. So:

(1) In *Standard Chartered Bank v Ceylon Petroleum Corporation* [2012] EWCA Civ 1049 (in which a different bank was claimant), the Court said that it was accepted that "… CPC had capacity to enter into derivative contracts for the purpose of risk management, but not for the purpose of speculation. However, we find that an unsatisfactory distinction. In the absence of a clear line between hedging and speculation it is likely to give rise to immense difficulties in practical operation".

(2) Similarly, at first instance, reference was made to "the blurred line between hedging and speculation" ([2011] EWHC 1785 (Comm) at [362]).

(3) In the *Vestia* case, ibid, at [214], it is said that it was "submitted that the distinction that Vestia draw between transactions that "genuinely constituted hedges" and speculation is a false one. I accept that, if not false, it is certainly an elusive one, and to my mind it did not prove to be a useful one. … It tended to distract from the important question, which is whether the contracts comprising the disputed transactions were within Vestia's objects."

230. Where there is a legal definition of "speculation" or other activities such as hedging to apply, the court's task is to apply it. But where there is not, as in this case, there are no clear lines to draw. The Transport Companies accept that they have the capacity lawfully to enter into swaps. This can legitimately be for the purpose of interest rate risk management, or hedging, or the reduction of borrowing costs. Their case is that

the swaps were outside their capacity as transactions that involved a speculation (or bet) on future interest rates with the objective of making profit.

231. However, it could be said that all swaps contain an element of speculation in this sense: in the case of vanilla swaps used for hedging against rises in interest rates, if interest rates fall, the counterparty paying the fixed rate will have turned out to make the wrong call. If rates rise, the swap will be an instrument with an inherent value that can be realised if desired. The same could be said of most investments.

232. There is a debate in the *Ceylon Petroleum Corporation* dispute as to whether or not the motive of the counterparty is relevant. The arbitral tribunal proceeded on the basis that it is possible to determine the question of speculation objectively. The Court of Appeal, on the other hand, considered that, "Without a formal definition, however, we think that it would be difficult to exclude all subjective elements from a consideration of whether a transaction was speculation or hedging" (ibid at [16]).

233. If it is relevant in the present case, it is common ground that none of the Transport Companies had any intention to speculate—if anything, the reverse was true. These transactions were seen as legitimate even desirable financial management of the companies' debt.

234. BST's submission is there is no basis in English law or in Portuguese law for treating 'speculation' as the opposite of 'risk management', and that the exercise of characterising the swaps as 'speculative' or 'non-speculative' is one in which the court need not engage, not least because none of the Portuguese law tests require this exercise to be performed.

235. Reference is made to the findings above in relation to the first question. Consistent with what is said in the above authorities, no further findings specific to the second question need be made here.

PART D: THE COURT'S APPROACH TO ISSUES OF PORTUGUESE LAW

The approach of the English court to issues of foreign law

236. This is a case where there are basic conflicts of evidence as to what Portuguese law is on a number of important issues. Moreover, as the Transport Companies point out, it is a case where the foreign law is not only in a foreign language (Portuguese), but also involves civil law concepts unfamiliar to English lawyers.

237. The approach of the English court in determining issues of foreign law is largely agreed, and can be summarised as follows:

(1) Foreign law is an issue of fact to be proved by expert evidence (*Dicey, Morris & Collins on the Conflict of Laws*, 15th edition, ¶¶ 9-002, 9-004, 9-0013). The burden of proof lies on the party who bases his claim or defence on it (ibid, at ¶9-025).

(2) If that party adduces no evidence, or insufficient evidence, of the foreign law on the relevant issues, the court applies English law (ibid, at ¶9-025).

(3) The court's approach to conflicts of expert evidence is to resolve the conflicts in the same way that it approaches other conflicts of fact (*Morgan Grenfell & Co Ltd v SACE Istituto Per I Servizi Assicurativi Del Commercio* [2001] EWCA Civ 1932, [48] (Clarke LJ)).

(4) In doing so, the court must bear in mind the purpose for which the evidence of foreign law is given: "This is to predict the likely decision of a foreign court, not to press upon the English judge the witness's personal views as to what the foreign law might be" (*MCC Proceeds Inc v Bishopsgate Investment Trust plc* [1999] CLC 417, 424-425 (Evans LJ)).

(5) In the light of this, the function of an expert witness on foreign law is: (i) to inform the court of the relevant contents of the foreign law; identifying statutes or other legislation and explaining where necessary the foreign court's approach to their construction; (ii) to identify judgments or other authorities, explaining what status they have as sources of the foreign law; and (iii) where there is no authority directly in point, to assist the English judge in making a finding as to what the foreign court's ruling would be if the issue was to arise for decision there (ibid, p. 424).

(6) "If the law is contained in a code or written form, the question is not as to the language of the written law, but what the law is as shown by its exposition, interpretation and adjudication". If there is a conflict of evidence, the court must decide on the conflicting testimony. The court "is not entitled to construe a foreign code itself" (*Lazard Brothers & Co v Midland Bank Ltd* [1933] AC 289 at p. 298 (Lord Wright)).

(7) Even when there is a proved or agreed translation, "it is still primarily the function of the expert witness to interpret its legal effect, in order to convey to the English court the meaning and effect which a Court of the foreign country would attribute to it, if it applied correctly the law of that country" (*A S Tallinna Laevauhisus v Estonian State SS Line* (1947) 80 Ll. L. Rep. 99 at 108 (Scott LJ)).

(8) The "function of the expert witness in relation to the interpretation of foreign statutes must be contrasted with his function in relation to the construction of foreign documents. In the former case, the expert tells the court what the statute means, explaining his opinion, if necessary, by reference to foreign rules of construction. In the latter case, the expert merely proves the foreign rules of construction, and the court itself, in the light of these rules, determines the meaning of the documents" (*Alhamrani v Alhamrani* [2014] UKPC 37 at [19] (Lord Clarke) approving *Dicey, Morris & Collins*, ibid, at ¶ 9-019).

(9) As to the identification of judgments and other authorities, the court "is not bound to apply a foreign decision if it is satisfied … that the decision does not accurately represent the foreign law" (*Dicey, Morris & Collins* ibid at ¶9-020). In addition, "where foreign decisions conflict, the court may be asked to decide between them, even though in the foreign country the question still remains to be authoritatively settled" (ibid at ¶9-020).

(10) It is evident that the quality of expert evidence before the court varies from case to case, and the above principles have to be applied in that light. As has been held in the context of the construction of foreign statutes, the degree of freedom which the English court has in putting its own construction on the translation of foreign statutes, arises out of, and is measured by, its appraisal of the expert evidence.

(11) Thus, if the expert "says that the foreign statute bears a meaning which is patently inconsistent with the words of the English translation, the Court is entitled to reject his construction unless he goes further and proves some extraneous rule of law, written or unwritten, of the foreign country which compels that apparently forced translation" (*Tallinna Laevauhisus* at p.108).

(12) As the defendants point out, in the *MCC Proceeds* case the court also said that it was only where there is no authority directly in point that there is "much scope in practice for opinion evidence, which is the basic role of the expert witness" (ibid at p.424).

(13) However, as the claimant submits (correctly in the court's view) in that case the Court of Appeal was discussing a jurisdiction (the United States) where the doctrine of precedent exists. Where there is a precedent, there may not be much scope in practice for opinion evidence. That is not, however, the position in a civil law jurisdiction like Portugal. As the evidence shows, in Portugal there are conflicting decisions even at the level of the Supreme Court of Justice and decisions where lower courts have rejected an approach previously adopted by a higher court. Thus, even if there is a decision directly on point, the English court may need to consider what a future court would decide.

238. There is no dispute as to how these principles apply in the present proceedings. BST asserts that the Transport Companies had capacity to enter the swaps, and therefore BST bears the burden of proof on this Portuguese law issue. The Transport Companies accept that they bear the burden of proof on the defences, that is, the game of chance, abnormal change of circumstances and Securities Code issues.

The structure of Portuguese law

239. Professor Paulo Câmara and Professor José Engrácia Antunes are largely in agreement about the structure of Portuguese law so far as relevant to these proceedings.

240. The Portuguese legal system is a civil law system. While being traditionally influenced by civil or continental legal systems found in other Western European countries (such as France, Italy and in particular Germany), EU law has now become a major driving force in many respects, especially in the areas of commercial, financial and company law.

241. Under the Portuguese legal system, the most relevant source of law is the statute ("*lei*").

242. The main statutory laws, listed according to their hierarchical status in a descending order, are: the Portuguese Constitution ("*Constituição da República Portuguesa*");

ordinary laws, such as Laws ("*Lei*") issued by the Parliament and Decree Laws ("*Decreto-Lei*") issued by the Government; and regulations, such as regulatory decrees, ministerial orders, or regulations of supervising agencies. As the Portuguese legal order is open to international integration, national statutory laws are subjected to principles of general international law and international agreements (namely, EU treaties).

243. Jurisprudence ("*jurisprudência*"), i.e., the set of court decisions, is not a source of law because in Portugal judges are not obliged to respect the precedent established by prior judicial court decisions ("*stare decisis*"). However, it plays an important role in the interpretation and application of statutory laws as the courts often take into consideration judicial decisions of other courts when deciding in similar matters.

244. Doctrine ("*doutrina*"), i.e. the opinion of legal commentators, is also not a source of law in Portugal. However, it plays an important role in the scientific systematisation of legal knowledge and may have significant repercussions on the final result of those responsible for drafting, interpreting and applying legal rules (legislators and courts).

245. Art. 9 of the Civil Code regulates the interpretation of statutory laws. According to this rule, the result of interpretation should take into account (1) the letter of the law, (2) the spirit of the law, (3) the history behind the law and the specific conditions of the time of its application, and (4) the unity of the legal system.

246. It is widely accepted in the Portuguese jurisprudence and doctrine that there are three criteria applicable in the case of conflict of legal rules: hierarchy (*lex superior derogat legi inferior*), posteriority (*lex posterior derogat legi priori*), and specialty (*lex specialis derogat legi generali*). (There is disagreement on the scope and content of the criterion of specialty but nothing more need be said here.)

PART E: THE CAPACITY ISSUE

The issues

247. Capacity has to do with the question of what a corporate entity can in law validly do, and if disputed by the company after a contract has been entered into, raises the consequence that the contract may be void, though all concerned have proceeded in good faith on the basis that it is valid, exposing the other contracting party to substantial losses.

248. This is the Transport Companies' case in these proceedings. They argue that their capacity is limited by their purposes as public enterprises, that is, the "public missions" which they pursue. They add that it is reasonable to expect a financial institution like BST to satisfy itself as to capacity before entering into a transaction.

249. They accept that they have the capacity to enter into hedging or risk management derivatives, or "financial management" derivatives, "specifically", instruments in connection with the "management of [the company's] borrowing". However they submit that it is contrary to their public missions to enter into speculative swaps, which increase their exposure to financial risk. They submit that the swaps at issue are all speculative in that they increase financial risk, and therefore fall outside the Transport Companies' capacity. That includes the two swaps that were not affected in

the same way as the others by low interest rates, one of which had a different formula for calculating the spread, the other having an upper but not a lower barrier.

250. It is BST's case that the Transport Companies have the same capacity to enter into derivatives as any private company, with the purpose of pursuit of profits, and that all the transactions were within their capacity. It points out that lack of capacity has not been raised as an issue before in Portugal despite the numerous disputes as to swaps, including those entered into by public enterprises, and their examination in various fora, including the Court of Auditors.

251. The issues as defined in the pre-trial agreed list of issues help give clarity to the main points of dispute:

(1) Did the company in each case have capacity to enter into the swaps? In particular:

a) Is the capacity of the Transport Companies limited by Art. 160 of the Portuguese Civil Code to the purposes specified in the RSBS or RLBS[17] (as appropriate)?

b) If so, were the swaps in each case necessary or convenient for the furtherance of those purposes? In particular:

i) Were the swaps in each case in substance speculative transactions, and if so did that mean that they were outside the capacity of the relevant Company?

ii) Did the swaps in each case adequately satisfy community needs, and if not did that mean that they were outside the capacity of the relevant Company?

iii) Did the swaps in each case contribute to the economic and financial balance or viability of the public sector and/or the relevant Company, and if not did that mean that they were outside the capacity of the relevant Company?

iv) Was it in the public or general interest for the relevant Company in each case to enter into the swaps?

(2) Is MdL a public authority subject so far as relevant to the requirements of the Administrative Procedure Code? If so does that make any difference to the analysis above? (This point was not pursued.)

(3) Are the swaps nevertheless binding and/or to be treated as being within the capacity of Carris, MdP and/or STCP, either as a matter of English law or by virtue of Article 6(4) of the Portuguese Companies Code (which gives effect to the abolition of the *ultra vires* rule by the EU Company Law Directives)?

[17] As to the RSBS and RLBS, see below.

252. Although the list of issues refers to the swaps "in each case", it was not suggested at trial that there were individual characteristics in the case of particular swaps that led to a different result (see above).

The nature of the Transport Companies

253. Each of the Transport Companies is a corporate entity, but they fall into two classes, and this is relevant to the parties' arguments. Carris, STCP and MdP are "*sociedade anónima*"[18] (abbreviated to "S.A.") incorporated under commercial law, and MdL is an "*entidade pública empresarial*" (abbreviated to "E.P.E.") constituted by decree-law.

254. All the Transport Companies are 'public enterprises', that is to say corporate entities wholly or majority-owned by public authorities, and have the following characteristics:

(1) Carris and STCP are public enterprises (*empresas públicas*), incorporated under commercial law, wholly owned by the State and operating in the State business sector, within the meaning of Arts. 2(1) and 3(1) of the Regime of the State Business Sector (Decree-Law 558/99) (the "RSBS"). Each is in the form of a "*sociedade anónima*" (stock corporation), a particular type of "*sociedades comerciais*" (commercial company). They are therefore regulated by their Articles of Association, the Code of Commercial Companies[19] and the RSBS.

(2) MdP is a metropolitan enterprise (*empresa metropolitana*) incorporated under commercial law, majority owned during the relevant period by the Porto Metropolitan Area, and operating within the local business sector, within the meaning of Arts. 2(1) and 3(1) of the Regime of the Local Business Sector (Law 53-F/2006) ("RLBS"). Again it is in the form of a "*sociedade anónima*". It is regulated by its Articles of Association, the Code of Commercial Companies and the RLBS, as well as the RSBS.

(3) MdL was nationalised after the 1974 Revolution in Portugal, and is a public business entity called an E.P.E. (*entidade pública empresarial*) constituted by decree-law, State owned and operating within the State business sector, within the meaning of Arts. 2(1), 3(2) and 23(1) of the RSBS. It is regulated by its own decree-law of incorporation (which also adopted its Articles of Association), the RSBS and the Code of Commercial Companies.

The parties' contentions

255. BST's expert was Professor David Duarte, and the Transport Companies' expert was Professor José Engrácia Antunes.

256. Professor Duarte's evidence is that the different legal form of the four companies gives rise to two different capacity rules, one applying to MdL and the other to Carris, STCP and MdP. Professor Antunes' evidence is that the fact that all of the entities are public enterprises means that they are subject to a single capacity rule.

[18] In full, *sociedade anónima de responsabilidade limitada*.
[19] In their submissions, the parties referred to this Code also as the Commercial Companies Code, or just the Companies Code, and the court has followed the wording they used.

257. To understand the dispute between them, it is necessary to appreciate that (on the Transport Companies' case) the term "purpose" or "ends" (in Portuguese, "*fim*" or "*fins*"[20]) is a distinct legal concept: it is not to be confused with a legal person's objects (or "*objecto*"). The Transport Companies' case is that the purpose of a legal person is the typical or general goal that a certain type or class of legal persons pursues, whereas its object is the specific activity to which it is devoted as specified e.g. in its Articles of Association.

258. BST responds that Professor Duarte does not maintain that the concepts of "purpose" and "object" are indistinguishable, but does not accept that under Art. 160 of the Civil Code, the "*fim*" of a company encompasses only its purpose and not its objects.

259. Based on their interpretation of the various legal instruments, in summary, the experts' contentions were as follows.

(i) Professor Duarte

260. Professor Duarte's evidence, and BST's case based on it, is as follows.

261. The capacity provisions relevant to the Transport Companies are those that apply to S.A.s and E.P.E.s generally. So far as S.A.s are concerned, this is Art. 6 of the Commercial Companies Code which applies in respect of Carris, STCP and MdP (as S.A.s).

262. Carris, MdP and STCP, as S.A. public enterprises, have capacity for any act, whether lying inside or outside their corporate objects as defined in their articles of association, provided only that the act is necessary or convenient to their purpose of seeking profit.

263. The purpose is clear, Professor Duarte argues, from various provisions of the Commercial Companies Code (reference being made to a decision of the Supreme Court of Justice of 27 January 2010, 2380/05.2TBOER.S1), and from Art. 980 of the Civil Code, which defines a contract of incorporation as a contract whereby two or more persons undertake to contribute assets or services with a view to jointly undertaking an economic activity with the purpose of distributing the profits therefrom.

264. In respect of MdL (as an E.P.E.), the capacity rule is found in Art. 25(2) of Decree-Law 558/99 (the RSBS). MdL, as an E.P.E. enterprise, has capacity for any act which is necessary or convenient to pursuing its objects, namely the activities defined in its articles of association.

265. As to the purposes/objects of S.A.s and E.P.E.s, the purpose or mediate end of S.A.s as a class is the pursuit of profits. The purpose or mediate end of E.P.E.s as a class does not limit their capacity and is therefore irrelevant, although BST's case is that such purpose is also the pursuit of profit. The relevant object of MdL is "the operation, on an exclusive and public services basis, of public passenger transport services...". For MdL, therefore, capacity is measured by whether the type of contract in question was necessary or convenient to this object.

[20] Singular and plural.

266. The test of convenience and/or “appropriacy” (as convenience has sometimes been described) is whether the means are capable of achieving the relevant ends, such that capacity encompasses all legal situations which, in some way, may help in achieving the legal person’s ends.

267. If the advantage offered by a type of contract is convenient/appropriate to a person’s ends, a particular contract that belongs to that type is within the person’s capacity. This is so, irrespective of whether its specific terms are more or less favourable, for example by being more or less speculative or at a higher or lower price.

268. Interest rate swaps offer advantages for the financial management of companies and so are necessary or appropriate acts to assist the Transport Companies achieve their ends. The swaps are therefore within the capacity of each of the Transport Companies.

(ii) Professor Antunes

269. Professor Antunes identifies the governing Portuguese rule on the capacity of legal persons in general i.e. Art. 160 of the Civil Code, commonly known as “principle of specialty of purpose”, which defines a legal person’s capacity by reference to its purposes or ends (“*fins*”). He then seeks to apply this general Portuguese legal principle to MdL, Carris, STCP and MdP by identifying their common “purpose” as a distinct type of legal person, that is, as “public enterprises”.

270. The purpose of public enterprises is the pursuit of their public interest missions as identified in Art. 4 of the RSBS (in the case of MdL, Carris and STCP) and Art. 7 of the RLBS (in the case of MdP). As a consequence, the capacity of these enterprises is not to be determined by reference to whether their acts are necessary or convenient for the pursuit of profit, as in the case of other S.A.s.

271. Professor Antunes says that public administration lawyers (like Professor Duarte) tend to regard such entities as operating exclusively as ordinary commercial companies. Company lawyers tend, by contrast, not to recognise public enterprises as operating as ordinary commercial companies.

272. Professor Antunes says that Professor Duarte’s analysis fails to explain what the purpose of MdL is as a legal person—and is thus in conflict with one of the most fundamental principles of Portuguese law on capacity, namely Art. 160 of the Civil Code.

273. The distinctive purpose of the Transport Companies is the pursuit of their public missions as set out in:

(1) Art. 4 RSBS, which is applicable to MdL, Carris and STCP, and which provides that the activity of State public enterprises “must be guided towards contributing to the economic and financial balance of the public sector as a whole and achieving adequate levels of satisfaction of the community’s needs”.

(2) Art. 7 RLBS, which is applicable to MdP and which provides that the management of local public enterprises “shall be coordinated with the

objectives pursued by the respective shareholding public entities, with a view to meeting needs in the general interest, promoting the local and regional development and the efficient operation of concessions, and ensuring the companies' economic viability and financial balance."

274. The consequence of this is that acts that are not conducive to i.e. necessary or convenient for the pursuit of the public enterprises' missions or purposes fall outside their capacity. More particularly, they may undertake profit-seeking acts only insofar as those acts prove to be appropriate or instrumental to the achievement of their core public interest goals.

275. Specifically, the Transport Companies may enter swaps that operate as instruments to protect the enterprises against risk (hedging), but not instruments that involve trading in risk (speculation). Hedging instruments are ones properly designed to eliminate, mitigate or manage exposure to some kind of risk, speculative instruments in this context simply being the obverse of these i.e. non-hedging instruments.

276. This conclusion, Professor Antunes says, in the absence of Portuguese jurisprudence, or indeed much Portuguese doctrine, is primarily a logical inference. But it is a logical inference that is consistent with the approach of similar civil law systems, in particular with German law, which has greatly influenced Portuguese law.

277. More importantly, whether swaps have two functions (hedging and speculation) or three (the reduction of financial costs), the swaps in dispute were incapable on an *ex ante* basis of hedging or reducing the financial costs of the Transport Companies. Accordingly, they fall outside the capacity of the Transport Companies and are void.

278. It likewise follows that, insofar as the ISDA Master Agreements were entered into only for the purpose of entering the (void) swaps, then they also are void, which was the case in relation to Carris, STCP and MdP. In relation to MdL, the validity or otherwise of the ISDA Master Agreement is an academic issue.

279. Based on this evidence, the Transport Companies invite the court to find that:

(1) The swaps entered into by MdL were outside its capacity (whichever theory of capacity is adopted) and are therefore void and of no effect.

(2) The Transport Companies only have capacity to enter into swaps that are consistent with their public purpose missions as set out in Art. 4 of the RSBS and Art. 7 of the RLBS.

(3) The swaps, being contrary to these public purpose missions, are void.

(4) The ISDA Master Agreements entered into with BST by Carris, STCP and MdP, solely for the purpose of entering into the void swaps, are void.

(5) MdL did not make any representations pursuant to its Master Agreement with BST in relation to MdL's capacity to enter into the void swaps.

Discussion and conclusion

(i) Introduction

280. The essence of Professor Antunes' evidence is that the general rule found in Art. 160(1) of the Civil Code to the effect that capacity is to be assessed by reference to a legal person's purposes, permits, indeed requires in the case of public enterprises, recourse to two particular provisions in order to identify the purposes—these are Art. 4 RSBS (in the case of MdL, Carris and STCP as state-owned enterprises) and Art. 7 RLBS (in the case of MdP as a local enterprise).

281. The essence of Professor Duarte's evidence is that the general rule has been displaced in the case of the Transport Companies by special rules applying to the category of legal persons to which they belong. The capacity provisions are contained in Art. 6 of the Commercial Companies Code in respect of Carris, STCP and MdP, these companies being S.A.s, and in Art. 25(2) of the RSBS in respect of MdL this company being an E.P.E.

282. As the Transport Companies put it in their written closing submissions, Professor Antunes adopts what might be described as a "top-down" approach, identifying the rule on the capacity of legal persons in general in Art. 160 of the Civil Code, and seeking to apply this to the Transport Companies by identifying their common "purpose" as what he regards as a distinct type of legal person, that is, "public enterprises".

283. Professor Duarte on the other hand, adopts what might be described as a "bottom-up" approach by reference to provisions which expressly regulate the capacity of entities within their ambit, under which he concludes that Carris, STCP and MdP have the same capacity as other commercial companies, and MdL is subject to the capacity rule in Art. 25(2) of the RSBS.

284. The court has to choose between these very different opinions. There is no Portuguese jurisprudence, or indeed doctrine, which settles the matter. In particular, BST points out that the capacity issue has not been raised before in relation to swaps. The Transport Companies reply that "snowball" type swaps have not yet come before the Portuguese courts.

285. Both these points are correct.

286. However, although the swaps that have come before the courts are not of the snowball type, similar swaps were closed out by public enterprises at considerable expense in 2013. No issue was raised as to capacity.

287. Further, the particular swaps the subject of this litigation have received attention from the Parliamentary Inquiry, were the subject of testimony by the officers of the Transport Companies and others who gave evidence to the inquiry, were dealt with in reports of the Inspector-General of Finance (IGF) into the swaps, and by the Court of Auditors.

288. The court considers that it is a matter of legitimate comment that, as BST puts it, if the capacity defence is correct, all of these persons were wrong and simply overlooked an obvious and critical point.

(ii) The opposing opinions

289. Professor Duarte's evidence centres on two provisions applicable to S.A.s and E.P.E.s respectively.

290. As to the former (MdP, STCP and Carris), Art. 6 of the Commercial Companies Code provides that:

> "6.1 The capacity of a company comprises the rights and obligations necessary or convenient for the furtherance of its purpose, except those which are prohibited by law or which are inseparable from natural personality.
>
> 6.2 Any gratuitous acts, if considered as usual practice, depending on the prevailing circumstances of the time and the conditions of the company itself, shall not be deemed as being contrary to the purpose of the company.
>
> 6.3 The provision of secured or personal guarantees for debts shall be deemed as contrary to the purpose of the company, except where the guarantor company has a justified interest, or it is a parent or subsidiary company.
>
> 6.4 Contractual clauses and corporate resolutions which establish the given object for the company, or prohibit it from certain acts, do not limit the capacity of the company, but impose on the company officers the duty of not overstepping this object, or of not carrying out these acts."

291. As to E.P.E.s (MdL), Art. 25(2) of the RSBS (Decree-Law 558/99) provides that:

> "Autonomy and legal capacity
>
> 1 ….
>
> 2 The legal capacity of public enterprise entities encompasses all the rights and all the obligations necessary or convenient for the pursuit of their objects."

292. The Transport Companies raise three principal objections to Professor Duarte's approach as explained above. The first two go together, namely that as companies they do not in fact pursue profit, and were described in the hearing as being "technically bankrupt", and that they do not operate in an ordinary market environment like ordinary commercial companies, remaining operational through State subsidies.

293. The court agrees with BST:

(1) That whether the companies are actually profitable is irrelevant to capacity.

(2) As to subsidies, it is reasonable to say, as the Transport Companies do, that it would be surprising if they could use public funds as if an ordinary commercial enterprise.

(3) But this goes to the conduct of the business they operate, and does not affect their capacity to enter into contracts.

(4) This view is consistent with the decision of the Constitutional Court cited by the Transport Companies (decision of 15 December 2010 (964/09)) which had to do with access to documents, and is not concerned with capacity.

294. The third objection goes to the legal principle that governs the capacity of legal persons. The Transport Companies say that principle of specialty of purposes embodied in Art. 160(1) of the Civil Code limits their capacity by reference to their purposes (or "*fins*"). Art. 6(1) of the Companies Code is in similar linguistic form, albeit that it refers to the capacity of a company in the singular, and thus to its end or purpose (or "*fim*"). Thus the Companies Code distinguishes a "*fim*" from a company's object or "*objecto*", which is defined in Art. 11 as the activity which a company is to carry out as specified in its articles of association.

295. Following on from that, the Transport Companies argue that Professor Duarte's analysis results in the anomaly that, whereas he is able to identify the source of the "purpose" of Carris, STCP and MdP as commercial companies, namely profit, he is unable to identify the source of the "purpose" of MdL. Although he asserts that all E.P.E enterprises seek profit, and so relies on profit in the case of E.P.E.s as well, he is not (the Transport Companies submit) able to identify the legal provision that specifies this. This means that MdL as an E.P.E enterprise is a legal person without a "purpose" or "*fim*", contrary to Art. 160(1) of the Civil Code, with the result that, anomalously for Portuguese law, only its object is relevant for determining its capacity in accordance with Art. 25(2) of the RSBS.

296. In the court's view, this is the most substantial objection to Professor Duarte's theory, and explains why the Transport Companies focused particularly on MdL in their closing submissions.

297. His response is that there is an overlap of terminology used in Art. 6 and Art. 25(2), in that the word 'purpose', which appears as a translation for the Portuguese '*fim*' but literally means 'end', is normally capable of including both the purpose of a given type of legal person (known as the mediate end or *fim mediato*) and the object of the activity carried on by the particular legal person, known as the immediate end or *fim imediato*. He says that the same is true of the general rule for capacity of legal persons in Art. 160 of the Civil Code, which provides that the capacity of legal persons encompasses all the rights and obligations necessary or convenient for the furtherance of their purposes ('*fins*').

298. As the Transport Companies say, there is a degree of artificiality in this analysis. But though the Transport Companies maintain that there is a bright line drawn in the literature, the view offered by Professor Duarte in fact has support.

299. BST places particular reliance on the work of Professor Pedro Paes Vasconselos, a respected academic, in which the following opinion is expressed:

> "The corporate purpose or object has great importance for the determination of the scope of the primary activity of the legal entity. Article 160 of the Civil Code in its text recognises for legal entities the legal capacity corresponding to the rights and obligations necessary or convenient for the pursuit of their purposes, except those that are prohibited by law or which are inseparable from the single personality. *The reference to the purposes of the legal entity made in this article should be understood in a broad sense, encompassing the corporate object*.[21]"

300. Professor Duarte also relies on profit in this context, and in particular on Art. 37 of MdL's Articles of Association. The Transport Companies say that such reliance is misplaced because that article does not in fact presuppose that MdL will make a profit, but only concerns the application of MdL's "results", as it puts it, "<u>if</u> there is a profit".

301. However, the court accepts BST's response. The use of the word "if" does not affect the analysis. Any company's ability to distribute profits is contingent on it making a profit, and it can make no difference if the provisions for distribution begin with, "if there is a profit", or any similar expression. The court rejects the third objection also.

302. In the light of all the evidence, the court's view is that no obstacle has been identified by the Transport Companies to Professor Duarte's opinion, and that the question is whether the evidence shows that the opinion of Professor Antunes is preferable as a matter of Portuguese law, the onus of proof being on BST in this respect.

303. Turning to the opinion of Professor Antunes, Art. 160(1) of the Civil Code provides that:

> "The capacity of a legal person encompasses all the rights and duties necessary or convenient for the furtherance of its purposes".

304. This encompasses all legal persons. The purposes identified by Professor Antunes applicable to public enterprises have to do with their public interest missions, and it is from these missions that he takes his view that what he regards as speculative swaps were outside the capacity of the Transport Companies.

305. Clearly, such enterprises do have important public interest missions, as of course the court accepts—but the question as it emerged in the evidence is whether these missions define the companies' capacity to enter into contracts, as opposed to being rules as to how they should conduct their businesses being businesses in the public sector.

[21] Italics added.

306. The position as regards the wording of Art. 4 of RSBS and Art. 7 of the RLBS from which Professor Antunes derives such purpose is not in fact entirely straightforward. This is because Art. 4 was amended in August 2007 and repealed in October 2013. It provided in un-amended and amended forms as follows:

> "The activities of State-owned companies and of the State corporate sector should be guided towards contributing to the economic and financial balance of the public sector as a whole and in achieving adequate levels of satisfaction in meeting the community's needs." (*Before amendment*)

> "The activity of the State corporate sector shall be directed towards achieving adequate levels of satisfaction of the needs of the community and shall be undertaken in accordance with stringent parameters regarding quality, economy, efficiency and effectiveness, while also contributing to the economic and financial balance of the entire public sector." (*After amendment*)

307. Prior to its repeal, Art. 7 of the RLBS provided in similar vein that:

> "The companies' management shall be coordinated with the objectives pursued by the respective shareholding public entities, with a view to meeting needs in the general interest, promoting the local and regional development and the efficient operation of concessions, and ensuring the companies' economic viability and financial balance."

308. The submissions on this issue centred on Art. 4, and for these purposes, it is not necessary to distinguish between it and Art. 7.

309. As can be seen from a comparison of the two versions of Article 4, the 2007 amendment inserted a requirement that the State corporate sector's activity be undertaken "in accordance within stringent parameters regarding quality, economy, efficiency, and effectiveness".

310. If Professor Antunes is correct, then this should form part of the capacity test as well. It was put to him in cross-examination that requirements like these clearly do not fit into a provision which is intended (as he says) to regulate capacity. He accepted this, but did not have a clear answer to the point:

> Q. … take the word "efficiency". Are we to judge the capacity of these corporations, in terms of the contracts they enter into, in terms of whether the contract produces efficiency or has entered into efficiency? How would you apply that, as a capacity test? Because, after all, when we are talking about capacity, we are talking about competence. Does the company have the competence to enter into that kind of contract? How would you apply it with the word" efficiency"?

> A. I see your point, and I think that these new parameters introduce, as I said, a sort of strange body in the middle of this legal provision.

311. In fact, Article 4 RSBS was repealed in 2013 and replaced with provisions requiring public authorities to issue guidelines and objectives on a triennial basis together with policies under which public enterprises are to develop their activities. This happened well after the last swap was entered into. Nevertheless, though Professor Antunes did not concede this (preferring not to comment), the court regards as convincing Professor Duarte's evidence that the repeal at least suggests that these rules are to do with management, and not with capacity at all.

312. But there is a more basic problem with Professor Antunes' approach. BST says that it is unworkable in practice, because it would be difficult, if not impossible, for either the public enterprise or third parties to determine at the time of concluding a transaction whether it was or was not within a public enterprise's capacity. This follows from the terms of Art. 4, referring as it does to "contributing to the economic and financial balance of the public sector as a whole and in achieving adequate levels of satisfaction in meeting the community's needs".

313. In short, how could this be established? This problem was accepted by Professor Antunes. In their submissions, the Transport Companies acknowledge that "Professor Antunes … accepted that applying the Art 4 RSBS 'purpose' test creates uncertainty for third parties". They respond that there is also uncertainty in applying the profit criterion.

314. The court does not accept this response. As BST says, there is a substantial difference between a third party having to determine whether a proposed contract is potentially capable of assisting its counterparty to make a profit (as opposed to for example gratuitously alienating its assets)—which is Professor Duarte's test—and the third party having to assess whether the contract will allow its counterparty to achieve financial balance for itself and the public sector as a whole, or adequate levels of satisfaction in meeting the community's needs. The court agrees with BST that it is hard to see how Professor Antunes' test would be workable.

315. There are further difficulties. Professor Antunes also acknowledged in cross-examination that whether an entity is a "public enterprise" or not, and thus subject to what he considers is the Art. 4 RSBS capacity rule, depends on the requisite level of State ownership. He pointed out that same contingency also determines whether the enterprise is subject to the RSBS, i.e. it is part of the jurisdictional threshold.

316. But the jurisdictional position can be established at any particular point in time. The difficulty arises if applied as a capacity rule. As BST says, it is not plausible that the purpose of an S.A., and hence its legal capacity, should change according to the proportion of its shares which may, at any one time, be held by the State.

317. This point is underlined by the fact that Art. 4 of the RSBS applies to the State corporate sector as well as State owned enterprises. A company becomes a member of the State corporate sector if the State acquires a 10% shareholding. As BST says, it would be extraordinary if such companies, by virtue of being subject to Article 4

RSBS, were to have their legal capacity curtailed by virtue of the State acquiring a 10% stake.

318. The conclusion said to follow from the Transport Companies' analysis is that they may enter swaps that operate as hedges, but not instruments that involve speculation. Hedging instruments are ones properly designed to eliminate, mitigate or manage exposure to some kind of risk, speculative instruments in this context simply being the obverse of these i.e. non-hedging instruments, and the swaps are speculative.

319. As to the jurisprudence, though there are a number of judicial decisions, and the approach is not always the same, the evidence is that Portuguese law recognises at least one other function of swaps. The Supreme Court in its judgment of 11 February 2015 (309/11.8TVLSB.L1.S1), which is also an important decision in the context of the "game of chance" issue, said that "these contracts entail one of three purposes: reduction of risk variation of the interest rates [i.e. hedges]; possibility of taking advantage of better rates; speculation on their variation".

320. The Lisbon Court of Appeal in its judgment of 2 July 2015 (2118-10-2TVLSB.L1.-2) followed the same approach, citing Mr Pedro Boullosa Gonzalez as saying that "three purposes are intended with the conclusion of a swap contract and, in particular, an interest rate swap: risk hedging or reduction, speculation and reducing financing costs".

321. The Transport Companies note that Mr Gonzalez is now a lawyer employed by BST. But there is no reason to regard this as relevant, since he was employed in September 2015, and the article was published in April 2013, and in any case his view was adopted by the Court of Appeal.

322. The court accepts BST's submission that "the possibility of taking advantage of better rates" and/or "reducing financing costs" was the purpose of these swaps, so that the distinction between hedges and speculation that Professor Antunes draws is not determinative. See in this regard the discussion above.

(iii) English authorities

323. The Transport Companies referred to two English decisions, *Hazell v Hammersmith and Fulham L.B.C.* [1992] 2 AC 1 and *Credit Suisse International v Stichting Vestia Groep* [2014] EWHC 3103. These decisions however depended on the particular provisions of national law that governed capacity, and do not assist in ascertaining Portuguese law as applicable in this case (*Standard Chartered Bank v Ceylon Petroleum Corporation* [2012] EWCA Civ 1049 at [28], [2011] EWHC 1785 (Comm) at [368]). The court was told in BST's oral closing submissions that the actual result of *Hazell* was reversed by s. 1 of the Localism Act 2011 by which a local authority has power to do anything that individuals generally may do.

(iv) Conclusion as to the capacity test

324. Both Art. 6 of the Commercial Companies Code and Art. 25(2) of the RSBS deal with capacity. This is what they say. There is some force, therefore, in BST's criticism that in his initial report, Professor Antunes made no mention of Art. 25(2), which also

presents an obstacle to his opinion that all public enterprises comprise a single type for capacity purposes.

325. Decisions of the Supreme Court of Justice of 27 November 2007 and 11 February 2010 provide some support to both parties' contentions as to the underlying profit issue.

326. As between them:

(1) The decision that contains an analysis of the profit issue is that of 11 February 2010 which involved MdP, and this supports BST's case as regards the companies which are S.A.s.

(2) The decision of 27 November 2007 describes MdL as a "non-profit company" and so supports the Transport Companies case, but there is no analysis of the issue.

(3) This description appears to be inconsistent with a decision of 19 February 2004 by which the Supreme Administrative Court found that MdL was a "for-profit economic organisation". (The finding is supported by academic authority).

(4) However, none of these decisions were in the context of capacity, and do not settle the question the court has to decide.

327. Professor Antunes is a distinguished commentator, and the court was greatly assisted by his evidence. But though it is not without its difficulties, as the Transport Companies have pointed out, the court prefers the evidence of Professor Duarte. The principal reason is that he provides a workable capacity test based on provisions which actually state that they deal with capacity for the companies within their ambit.

328. Professor Antunes on the other hand relies on provisions that have no immediately obvious role in this respect. He recognised the problems presented by his reasoning, but did not draw the conclusion that the court considers correct, which is that the provisions he relies on are intended only as principles of good management. They are norms of conduct, not of competence. Further, the court accepts Professor Duarte's evidence that publicly owned corporate entities are not a distinct class of legal persons subject to separate capacity rules.

(v) The capacity of MdL on the basis that BST's capacity test is correct

329. From their closing submissions, the court does not understand it to be in contention that on the application of Professor Duarte's test, the Transport Companies' case as regards MdP, STCP and Carris (each an S.A.) does not succeed.

330. The court is in any case satisfied (as BST submits) that each of the swaps was capable, at the time of its execution, of assisting the Transport Company that entered into it to achieve its relevant ends (purpose or object) of pursuing profit (Carris, MdP, STCP). The Transport Companies' case made as to the speculative nature of the swaps, even if correct, does not affect that conclusion. Accordingly, the court finds that it lay within the legal capacity of these companies to enter into the swaps.

331. The court need not decide BST's alternative submission that it is also entitled to succeed on the test contended for by the Transport Companies.

332. The Transport Companies' case however is that, even on the hypothesis that Professor Duarte is correct, MdL as an E.P.E. lacked the capacity to enter into the swaps it entered into.

333. This case is based on a new argument advanced for the first time (certainly in the form advanced) in written closing submissions.

334. It is asserted that:

(1) It follows from Professor Duarte's evidence that in order to know whether an act is within the capacity of MdL, it is first necessary to identify its objects as set out in its Articles of Association.

(2) Art. 2(1) establishes MdL's main object as maintaining Lisbon's underground public transportation, and Art. 3 establishes secondary objects "…which do not undermine the pursuit of its primary object and aiming at the best achievement of social objectives and the best use of available resources".

(3) Chapter V of the Articles deals with "asset and financial management". MdL does not have an express power to enter into derivatives, and whether it has capacity to enter the swaps therefore will depend on whether these instruments are appropriate for (or, in the words of Art. 25(2) of the RSBS, necessary or convenient for) MdL's express power to borrow in pursuit of its objects.

(4) As to that, those borrowing powers are subject to "basic management principles" as set out in Art. 29 of MdL's Articles of Association. The Transport Companies rely in particular on passages in Art. 29 which refer to "principles of economy that can be fixed objectively", "Whenever, for reasons of social economic policy the [MdL] is imposed with maintenance of facilities, the provision of services or the practice of rates that, within predetermined standards of productivity are not compatible with a balanced economic and financial management, the State should compensate the company in order to allow that balance", and "An objective should be to minimise costs through better use of resources made available to the company, in order to achieve maximum effectiveness in contributing to economic and social development".

(5) Although MdL had the capacity to make profits, it was envisaged that for reasons of "social economic policy" it would not always make profits and would therefore need to be compensated by the State in order to ensure a balanced economic and financial management.

(6) These "management principles" in pursuit of the "social objective" of a "collective transportation system" accord with its "mission" as an "*empresa pública*" as set out in Art. 4 of the RSBS whether or not this provision is properly characterised as no more than a management principle, as Professor Duarte would have it, or a "purpose rule", as Professor Antunes would have it.

(7) It follows from a combination of MdL's objects, its management principles and Art. 4 of the RSBS, that MdL is only permitted to enter into derivatives that are "appropriate" i.e. "necessary" or "convenient" for the exercise of its power to borrow, in pursuit of its objective of running a collective transportation system, consistently (as specified in its management principles) with the principle of pursuing a "balanced" economic and financial management and, insofar as derivatives are entered into with a view to reducing costs, consistently with "contributing to economic and social development".

(8) It follows from this that it is necessary to ask whether the swaps were incidental to MdL's borrowing power, having regard to the express management principles to which it was subject.

(9) The court should find that swaps that are risk-hedging are necessary and/or convenient for MdL's power of borrowing in pursuit of its object, and swaps that are cost-reducing are necessary and/or convenient for MdL's power of borrowing in pursuit of its objects, provided (in accordance with Art. 29 of its Articles of Association) that this cost reduction is consistent with the aim of "contributing to [MdL's] economic and social development", but that swaps which are speculations, or swaps which reduce costs but at the risk of jeopardising MdL's "economic and social development", are not necessary or convenient for MdL's power of borrowing in pursuit of its objects i.e. they are not "incidental to the incidental".

(10) Applying these criteria, MdL's swaps neither serve the purpose of risk management, nor are they effective to minimise MdL's costs in a way that maximises MdL's effectiveness in contributing to its economic and social development. Indeed, they threatened at inception the very economic existence of MdL. They are therefore also inconsistent with the management aim or principle of achieving a "balanced economic and financial management".

(11) The "inevitable consequence" is that the swaps fall outside the capacity of MdL and are null and void.

(vi) Conclusion as to the capacity of MdL on the basis that BST's capacity test is correct

335. Despite the complexity of the argument, the court's view is that essentially it imports Professor Antunes' contentions through the vehicle of MdL's Articles of Association. As such, it suffers from the problems identified above, indeed highlights them, since the contention is that swaps that are cost-reducing are necessary and/or convenient for MdL's power of borrowing in pursuit of its objects, and therefore within its capacity, provided that this cost reduction is consistent with the aim of "contributing to [MdL's] economic and social development".

336. As noted earlier, as a body that runs the metro system in a great European capital city, Metropolitano de Lisboa has substantial financing requirements. It has entered into many swaps, and doubtless other means of financial management as well. For reasons already given, the court does not consider that a capacity test applicable to such a body that involves great uncertainty represents Portuguese law.

337. The Transport Companies accept that reliance on Art. 29 is new, but say that the argument has already been raised, albeit briefly, in written opening submissions. It is said that the translation of the article is agreed, and that it would be extremely odd if the court did not take it into account, having been taken to other articles in the document.

338. BST objects to this course. The argument was not advanced or addressed in any evidence of Portuguese law given to the court, and was not put to Professor Duarte. The court is unable, it is submitted, without evidence from a Portuguese lawyer, to interpret Art. 29. Professor Antunes did not address it, because his evidence was centred on what he maintained were the purposes, not the objects, of the Transport Companies. An expert in Portuguese law may take the view that parts of the article other than those identified by the Transport Companies are relevant. The new argument is constructed outside the expert evidence, and there is no basis in Portuguese law for saying that in order to be within MdL's capacity, a transaction has to be anything more than convenient to the pursuit of its objects as set out in its objects clause. There is no basis, BST submits, for saying that Art. 29 is relevant to the question of what is convenient to the pursuit of MdL's objects.

339. The court accepts BST's submission in this respect. As set out in the English authorities referred to above, the court is not entitled to construe these provisions itself. This is not a technical objection, because in a field of law as recondite as capacity, the court has to gain its understanding through the Portuguese law experts.

340. But for the reasons given, it is very unlikely that this argument would have affected the court's conclusion. The court is satisfied that (as BST submits) each of the MdL swaps was capable, at the time of its execution, of assisting MdL to achieve its relevant ends (purpose or object) of operating a transport system. It does not accept the Transport Companies' submissions that the swaps lay outside its capacity as being speculative.

(vii) The Company Law Directives point

341. BST has a further submission that so far as concerns Carris, MdP and STCP, the swaps are binding on them even if they were outside the capacity of those companies. This is because each of them is a *sociedade anónima* ('S.A.') identified in Directives 68/151/EEC and 2009/101/EC (the 'Company Law Directives') as companies whose acts are binding even if outside capacity.

342. This was not subject to detailed analysis in rebuttal by the Transport Companies, but in view of its above findings, the court does not need to decide this submission.

343. It is for BST to establish capacity, and the court considers that it has done so.

PART F: NON-DEROGABLE RULES: ART 3(3) OF THE ROME CONVENTION

The dispute

344. The Transport Companies advance defences that arise under provisions of Portuguese law that apply to "games of chance" and "abnormal change of circumstances".

345. The swaps, however, are all subject to an express agreement that English law shall apply. There is no dispute as to the validity of such agreement. It follows that these defences depend upon establishing the application of Portuguese law in these respects despite the choice of English law. The issue depends on the correct application of the European rules contained in the Convention on the Law Applicable to Contractual Obligations 1980 (the Rome Convention).

346. In summary, the Transport Companies' case is that applying the test in Art. 3(3) of the Rome Convention, all elements relevant to the situation at the time of the contract are connected with Portugal. That being so, the choice of English law does not prejudice the application of "mandatory rules" of Portuguese law.

347. This is disputed by BST, which further disputes that the rules as to "abnormal change of circumstances" are "mandatory" in this sense.

The terms of Article 3(3)

348. The principle of freedom of choice of law in contract, or party autonomy, is recognised in European law. Art. 3(1) of the Rome Convention provides that:

> "1. A contract shall be governed by the law chosen by the parties. The choice must be expressed or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or a part only of the contract."

349. The Rome Convention applies to all the swaps because they were all concluded prior to 17 December 2009, when its successor the Rome I Regulation[22] came into effect.

350. By way of comparison, Art. 3(1) of the Rome I Regulation is essentially the same as its Convention predecessor:

> "1. A contract shall be governed by the law chosen by the parties. The choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or to part only of the contract."

351. The dispute between the parties centres on the qualification that applies where all elements relevant to the situation (other than the choice of law) are connected with one country only. In such a case, the parties' choice is not to prejudice the application of rules of the law of that country which cannot be derogated from by contract (called "mandatory rules"). Art. 3(3) of the Rome Convention provides that:

> "3. The fact that the parties have chosen a foreign law, whether or not accompanied by the choice of a foreign tribunal, shall not, where all the other elements relevant to the situation at the time of the choice are connected with one country only, prejudice the application of rules of the law of that country

[22] Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations.

> which cannot be derogated from by contract, hereinafter called 'mandatory rules`."

352. By way of comparison, the principle as contained in Art. 3(3) of the Rome I Regulation is in somewhat different terms (though Recital 15 to the Regulation makes clear that "no substantial change is intended as compared with Article 3(3)" of the Convention):

> "3. Where all other elements relevant to the situation at the time of the choice are located in a country other than the country whose law has been chosen, the choice of the parties shall not prejudice the application of provisions of the law of that other country which cannot be derogated from by agreement."

353. The reference to "mandatory rules" is omitted in Art. 3(3) of the Rome I Regulation. Recital 37[23] indicates that this is to distinguish the concept of "overriding mandatory provisions" (dealt with in Art. 9) from the expression "provisions which cannot be derogated from by agreement" which is the subject matter of Art. 3(3)[24].

354. BST draws attention to the fact that versions of Art. 3(3) in different European languages including the Portuguese language do not contain the words "relevant to", referring only to "all other elements of the situation". This "aberration" in the English language version is relied on in the context of the contention that the provision is to be read narrowly.

355. The court agrees with the Transport Companies that this difference in wording is unlikely to make any difference. As they point out, the Giuliano Lagarde Report to which, pursuant to s. 3 of the Contracts (Applicable Law) Act 1990, regard may be had for the purposes of interpretation, itself uses the words "relevant to the situation" in its commentary on the provision, as do the leading English commentaries. (The 1990 Act is the statute which gives the Rome Convention the force of law in England.)

Principles of interpretation

356. The principles of interpretation of the Rome Convention are not in dispute, and can be taken from the Transport Companies' submissions for trial:

(1) The Rome Convention is a "closed" international treaty, restricted to the Member States of the EU (Art. 28(1)). Although not adopted under the EC Treaty, it was adopted as part of the then European Community's programme to establish uniform rules across the Community in the field of private international law; it was intended to be complementary to the Brussels Convention (Recitals 1 and 2).

[23] "Considerations of public interest justify giving the courts of the Member States the possibility, in exceptional circumstances, of applying exceptions based on public policy and overriding mandatory provisions. The concept of 'overriding mandatory provisions' should be distinguished from the expression 'provisions which cannot be derogated from by agreement' and should be construed more restrictively."

[24] See also the explanation in Plender and Wilderspin, *European Private International Law of Obligations* (4th ed, 2015) at ¶6-060.

(2) Accordingly, like any other international treaty and EU legal instrument, it is to be interpreted:

a) Adopting a purposive approach, and not literally (*Samcrete Egypt Engineers and Contractors S.A.E. v Land Rover Exports Limited* [2001] EWCA Civ 2019 at [26]), Art. 33 providing that each of the different languages is "equally authentic".

b) With a view to "achieving uniformity" in its "interpretation and application" (Art. 18).

(3) So far as aids to interpretation are concerned, s. 3 of the Contracts (Applicable Law) Act 1990 provides that:

a) Any question is to be determined in accordance with the principles laid down by, and any relevant decision of, the European Court;

b) Regard may be had to the Giuliano Lagarde report.

(4) In addition, as a supplementary aid, consistent with EU principles of interpretation and the Vienna Convention on the Law of Treaties (Art. 32), recourse may be had to the preparatory works and to the circumstances of the Convention's conclusion.

The issues as to Article 3(3)

357. The first issue in relation to Art. 3(3) is whether notwithstanding the choice of English law, "*all the other elements relevant to the situation at the time of the choice*" are connected with Portugal, so that rules of Portuguese law which cannot be derogated from by contract apply to the swaps.

358. The Transport Companies contend that they are, and that Art. 3(3) is engaged. BST contends that there are a number of elements of the situation not connected with Portugal, and that Art. 3(3) is not engaged.

359. This is relevant to the "games of chance" defence and the "abnormal change in circumstances" defence.

360. The second issue is as to whether the provisions of Portuguese law as regards "abnormal change in circumstances" are "mandatory rules" in the sense that they cannot be derogated from by contract (it being conceded by BST that the rules relating to "games of chance" are mandatory).

361. The dispute does not affect the question of capacity which is outside the scope of the Rome Convention and (in broad terms) is governed by the law of the place of incorporation (*Haugesund Kommune v Depfa ACS Bank* [2010] EWCA Civ 579 at [27]).

362. BST also accepts that the court must apply the relevant provisions in the Portuguese Securities Code regardless of the contractual choice of English law. This was conceded by BST on the basis that the Transport Companies accept that their claims

under the Securities Code are to be treated as arising in tort, and so are to be treated as non-contractual claims which fall outside Art. 3(3) of the Rome Convention.

363. The court considers that BST's concession was correctly made, and need not consider whether it was justified on wider grounds, e.g. that regulatory provisions of this kind apply regardless of any choice of law. One of the functions of the Securities Code is to implement in Portuguese law directives that contain certain common conduct of business rules applicable throughout the EU to the provision of financial services.

The Transport Companies' arguments summarised

364. The Transport Companies argue that:

(1) Art. 3(3) must be interpreted in the light of the scope of the Rome Convention, which is set out in Art. 1(1): "The rules of this Convention shall apply to contractual obligations in any situation involving a choice between the laws of different countries."

(2) It includes within its scope situations with an international character within the meaning of the conflicts of law, and situations where there is no foreign element save for a choice of foreign law by the parties.

(3) In circumstances where there is a choice of foreign law by the parties, the primary rule in Art. 3(1) provides that the contract shall be governed by that law, i.e. the parties are prima facie entitled to displace the mandatory rules of the legal system in which they are operating.

(4) Art. 3(3) provides for the non-application of the primary rule in circumstances where "all the other elements relevant to the situation at the time of choice are connected with one country only". In such circumstances, the parties' choice of law cannot "prejudice the application of rules of the law of that country which cannot be derogated from by contract" ("mandatory rules").

(5) Art. 3(3) strikes a balance between the parties' choice of law (which determines the applicable law of the contract) and the "legitimate interests" (Clarkson and Hill, *The Conflicts of Laws*, 4th Edition, p. 231) of the legal system in which the parties are operating. It does so by limiting the parties' ability to displace the mandatory rules of that legal system in circumstances where, but for the parties' choice of law, the law of that legal system would apply to the contract.

(6) The objective of Art. 3(3) is to prevent the parties from circumventing the non-derogable rules of that legal system in circumstances where there would be no possibility of a conflict of laws, but for their choice of law.

(7) When only two systems of laws are potentially in play (i.e. there is no possibility of the laws of a third country being applicable), the effect of Art. 3(3) is that the law chosen by the parties governs their contractual obligations, but it does not displace the mandatory rules of the legal system which, but for the choice, would undoubtedly apply.

(8) *Dexia Crediop SpA v Comune di Prato* [2015] EWHC 1746 (Comm) is the most relevant authority because it concerned the applicability of Art. 3(3) to interest rate swaps under an ISDA Master Agreement containing an English law choice of law clause. The parties were incorporated in Italy, the swaps were entered into in Italy, and were to be performed in Italy. The court decided that the use of a standard form ISDA Master Agreement and back-to-back swaps with a bank outside Italy were not relevant for the purposes of Art. 3(3) and that, in the case of the ISDA Master Agreement, it was not, in any event, connected with a country other than Italy.

(9) BST has failed to identify any factor or "situation" that relevantly connects the swaps to the law of any country other than Portugal. None is present where (a) BST and each Transport Company is a Portuguese entity; (b) each of the 9 disputed swaps was negotiated and entered into in Portugal; and (c) all of the relevant obligations under the swaps (which consist of payment obligations) are to be performed in Portugal.

(10) Accordingly, BST has failed to identify any relevant factor that, absent the choice of law and jurisdiction clauses, would indicate that the swaps were anything other than purely domestic Portuguese agreements. The swaps fall outside the scope of the law of conflicts altogether.

(11) It necessarily follows that Art. 3(3) of the Rome Convention, and therefore Portuguese mandatory law, apply to the swaps. Were this not the case, BST and the Transport Companies, by the mere expedient of their choice of law clause, would be able to circumvent the mandatory laws of the country which is alone concerned with the relevant transactions i.e. the mandatory law of Portugal. That would be contrary to the policy underlying Art. 3(3).

BST's arguments summarised

365. BST submits that Art. 3(3) of the Rome Convention is not engaged in the present case.

(1) Freedom of contract is the cornerstone of the Rome Convention, and to give effect to this principle any derogation from such freedom must be strictly necessary.

(2) The purpose of Art. 3(3) is to prevent abuse through the selection of a foreign choice of law. Art. 3(3) needs to be construed, purposively, in light of that objective.

(3) Art. 3(3) should be given a narrow interpretation. It is only when, truly, all the elements of the situation are connected with one country alone (i.e., are 'domestic') that it will be engaged. Any uncertainty should be resolved on the basis of such a narrow interpretation.

(4) As a corollary, the expression "elements of the situation" is to be given the widest interpretation. All elements of the contract are relevant, and the "situation" goes well beyond the terms of the particular contract.

(5) As a consequence of the foregoing, it will be very rare indeed for Art. 3(3) to be engaged in commercial litigation. The present dispute certainly does not provide such a case. There are a number of elements relating to the swaps which point to the international nature of the situation, and outside Portugal.

(6) There can be no good policy objection to a narrow interpretation of Art. 3(3) in commercial cases. This will not, for example, open the door to the abusive choice of foreign law clauses in consumer or employment law cases, since the Rome Convention specifically prevents that happening in these protected relationships. Similarly, the application of any foreign law is subject to the overriding mandatory rules of the forum (Art. 7(2)), and a general public policy exception (Art. 16).

(7) On the other hand, there are strong policy reasons why Art. 3(3) should not apply to contracts in the European OTC interest rate derivatives market.

(8) There is no suggestion that the choice of English law was abusive or evasive, or made otherwise than freely between the parties.

(9) The facts of the *Dexia* case make it distinguishable from the present case, and in any event the reasoning of the court in that case was wrong and should not be followed.

The law as to the application of Article 3(3)

(i) Authority at the European level

366. In the case of contracts, priority is given to the intention of the parties, to whom Art. 3 of the Rome Convention grants freedom of choice as to the law to be applied (*Intercontainer Interfrigo SC (ICF) v Balkenende Oosthuizen BV and MIC Operations BV* (Case C-133/08) at ¶¶23-24).

367. There is no decision at the European level determinative of the questions as to the interpretation of Art. 3(3) that arise in this case. BST cited *United Antwerp Maritime Agencies (Unamar) NV v Navigation Maritime Bulgare* (Case C-184/12) at ¶49[25] for the proposition that as an incursion into the parties' choice of law, and hence into their agreed rights and obligations, Art. 3(3) needs to be strictly interpreted.

368. However, the passage in *Unamar* which BST relies on relates to overriding mandatory provisions under Art. 7 of the Convention, and Art. 3(3) embodies a wider concept (see Recital 37 of the Rome I Regulation referred to above; *Dicey, Morris & Collins*, ibid, at 32-087).

369. BST also referred to cases considering derogation from the general rule on jurisdiction contained in the Brussels I Regulation and Brussels Convention. These

[25] "Thus, to give full effect to the principle of the freedom of contract of the parties to a contract, which is the cornerstone of the Rome Convention, reiterated in the Rome I Regulation, it must be ensured that the choice freely made by the parties as regards the law applicable to their contractual relationship is respected in accordance with Article 3(1) of the Rome Convention, so that the plea relating to the existence of a 'mandatory rule' within the meaning of the legislation of the Member State concerned, as referred to in Article 7(2) of that convention, must be interpreted strictly."

state that specific rules that derogate from the general rule should not be given an interpretation broader than is required by their objective: see *BVG v JP Morgan Chase Bank NA* (Case C-144/10) at ¶30, and *Hassett v South Eastern Health Board* (Case C-372/07) at ¶19. The CJEU has said that instruments that deal with applicable law and jurisdiction are to be treated as part of a coherent system, and to be interpreted consistently with each other (*Intercontainer Interfrigo SC*, supra, at ¶22, *Koelzsch v Grand Duchy of Luxemburg* (Case C29/10), at ¶33).

370. Applying this approach, what is the objective of Art. 3(3)? As set out in various commentaries placed before the court, the drafting of Art. 3(3) and its successor in the Rome I Regulation was the subject of discussion and compromise (e.g. Michael McParland, *The Rome I Regulation on the Law Applicable to Contractual Obligations* (1st ed, 2015), chapter 9).

371. According to the Max Planck Institute for Foreign Private and Private International Law, "Under art. 3(3) of the Rome Convention, internally mandatory rules cannot be derogated from by a parties' choice of law if the contract to which they refer has no significant foreign element. The policy behind this approach is to prevent the parties from evading internally mandatory rules in what is for all practical purposes a purely domestic case"[26].

372. On the other hand, as Mr Ali Malek QC for the Transport Companies pointed out, it has been said that the application of Art. 3(3) "… does not depend upon any showing of evasiveness or bad faith in choice of law. … Instead it reflects a basic sense that if the situation was entirely connected to one country, some aspects of the law of that country have a claim to be applied. The question is when Art. 3(3) applies, and which aspects of the law are picked up when it does" (Adrian Briggs, *Private International Law in English Courts* (1st ed, 2014) at ¶7.116).

373. In the court's view, this shows that whilst the underlying policy is to prevent the parties from avoiding internally mandatory rules in what is for all practical purposes a purely domestic case, there is no need to show evasiveness or bad faith. It is the state of affairs which matters. There is no suggestion that by adopting ISDA Master Agreements governed by English law either party set out to evade Portuguese law. The question is whether this is a purely domestic case.

374. One other factor should be mentioned. At least in the context of major financial contracts such as those at issue in this case, legal certainty is an important consideration. Professor Briggs expresses the view that, "The principle of the matter would appear to be that if elements relevant to the situation at the time of the choice of law are substantially located in a country other than the country whose law has been chosen, that may be enough to trigger the application of Article 3(3). But in practice, and particularly in commercial litigation before the English courts, this is only very rarely liable to arise for consideration. The uncertainty of the rule should lead to its narrow interpretation" (ibid at ¶7.117). The court agrees with this statement, and there are in fact only a few English decisions on Art. 3(3).

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[26] Comments on the European Commission's Green Paper on the conversion of the Rome Convention into a community instrument and its modernization at p. 16 (cited in McParland, ibid, at p.322). In the Rome I Regulation, the word "situation" rather than "contract" was retained.

(ii) English court decisions

375. These decisions are:

(1) *Caterpillar Financial Services Corporation v SNC Passion* [2004] EWHC 569 (Comm), in which a claim was made under a loan agreement in the context of a shipbuilding contract. The parties were of different nationalities, a point of difference to the present case. The court also treated the connection between the contracts as relevant to the application of Art. 3(3). In holding that it did not apply, the court pointed out at [18] that, "It is noteworthy that Article 3(3) refers to elements 'relevant to the situation' which is wider than 'elements relevant to the contract' …".

(2) *Emeraldian LP v Wellmix Shipping Ltd* [2010] EWHC 1411 (Comm), which involved a charterparty and a connected guarantee, and the same result was reached, albeit without detailed reasoning. Again, the Transport Companies point out that the parties were of different nationalities.

(3) *Bankers Trust International plc v RCS Editori SpA* [1996] CLC 899, in which the question arose whether Art. 3(3) applied to swap contracts under an ISDA Master Agreement between an English company and an Italian company: however, the court did not have to decide it.

(4) *Dexia Crediop SpA v Comune di Prato* [2015] EWHC 1746 (Comm), in which the court applied Art. 3(3) to interest rate swaps under an ISDA Master Agreement containing an English law choice of law clause. The parties to those agreements were both incorporated in Italy, the swaps were entered into in Italy, and were to be performed in Italy. The Transport Companies say that this decision is effectively on the same facts as the present case, and submit that the same result should be reached. This submission will require careful further consideration.

376. Pointing to the back-to-back hedging contracts it entered into, BST places reliance on commentary on linked contracts. Dicey, Morris & Collins (ibid) say at ¶ 32-087 that, "Art. 3(3) does not apply to cases which are apparently connected with one country, but in fact have some connection with other countries, such as string contracts or insurance arrangements": the *Caterpillar* case is cited in support. The Transport Companies respond that this is no more than a generalised observation about the circumstances in which such related contracts might be relevant, and says nothing about the degree to which such contracts must be related.

(iii) Portuguese court decisions

377. There are three recent decisions of the Portuguese courts which concern swaps entered into under ISDA agreements in which BST is the defendant (the third decision concerns the four swaps with MdL which are the subject of this case).

378. These were cases concerned with jurisdiction rather that choice of law. Deciding in favour of BST, the Portuguese courts gave effect to the choice of English jurisdiction.

379. The decisions are:

(1) The first instance decision of the District of Lisbon Central Court, 1st Civil Section of 15 January 2015 (542/14.0TVLSB) (*Sociedade Metropolitana de Desenvolvimento S.A. v BST*) which was upheld by the Lisbon Court of Appeal decision of 8 September 2015 (542/14.0TVLSB.L1).

(2) The first instance decision of the District of Lisbon Central Court, 1st Civil Section of 14 July 2015 (538/14.2TVLSB) (*Sociedade de Desenvolvimento do Norte da Madeira v BST*).

(3) The first instance decision of District of Lisbon Central Court, 1st Civil Section of 12 October 2015 (120/14.4TVLSB) (*DT – Associação para a Transparência e Democracia v Metropolitano de Lisboa and Banco Santander Totta SA*).

380. The cases concerned the application of Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (Brussels I), and not, as the Transport Companies point out, questions of choice of law under the Rome Convention. Further, the Transport Companies say that the decisions are under appeal and are not *res judicata* as a matter of Portuguese law. They say that Art. 18 of the Rome Convention by which regard may be had to judicial interpretation from elsewhere in Europe when interpreting the Convention is not concerned with the uniformity of interpretation of rules across different European legal instruments. They submit therefore that these decisions should be disregarded by the court as they are entirely irrelevant to the interpretation and application of Art. 3(3).

381. However, BST submits that whether Brussels I is engaged involves similar considerations as to whether there is a non-domestic element of the situation under Article 3(3). This is because in the words of the Report on the predecessor Brussels Convention by Paul Jenard, “it alters the rules of jurisdiction in force in each Contracting State only where an international element is involved” (see the decision of the CJEU in *Owusu v Jackson* (Case C-281/02), at ¶25). This point was considered by the Portuguese courts in relation to the contentions of the claimants that swaps entered into with BST were purely domestic contracts, and therefore, BST submits carries weight in relation to the dispute as to the application of Art. 3(3).

(iv) Analysis of the key issues

382. The Transport Companies cite the writings of Professor Allan Phillip (*Mandatory Rules, Public Law and Choice of Law*, in North ed., *Contract Conflicts* (1982), p. 97) for the proposition that where the facts are such that there is no conflicts of law problem at all, the mandatory law provisions of the domestic law of the contract will continue to apply notwithstanding the choice of a foreign law.

383. They submit that when there are only two systems of laws potentially in play—i.e. the domestic law and the choice of law—and there is <u>no</u> possibility of the laws of a third country being applicable, the effect of Art. 3(3) is that the law chosen by the parties governs their contractual obligations, but it does not displace the mandatory rules of the legal system which, but for the choice, would undoubtedly apply. This is a restriction on the party’s autonomy the purpose of which is to “prevent parties from circumventing the non-derogable rules of a country, in a wholly domestic situation, by

the simple expedient of selecting as an applicable law some legal system which fails to contain those rules" (Plender and Wilderspin, ibid, at ¶6-061).

384. The Transport Companies say that on BST's analysis, the application of Art. 3(3) is restricted to circumstances in which not only are there no foreign elements relevant to the question of the applicable law, but also there are no random, additional foreign elements to the situation, even though such elements are irrelevant to the question of the applicable law pursuant to the Rome Convention. They submit that this is a curious interpretation in the context of a Convention whose scope is "contractual obligations in any situation involving a choice between the laws of different countries".

385. In support, the Transport Companies place particular reliance on the decision in *Dexia v Comune di Prato*, supra. In that case Dexia, an Italian bank, had entered into a series of swap agreements with Comune di Prato, an Italian local authority. The swaps were governed by an ISDA Master Agreement and the confirmations were in English and subject to English law and jurisdiction. In resisting Dexia's demand for payment, Comune di Prato sought to rely on certain provisions of Italian law as being mandatory.

386. As in the present case, the bank disputed that Art. 3(3) applied. It contended that there were two "elements relevant to the situation" which were not connected with Italy:

(1) The master agreement was in the standard ISDA form, drafted by international working groups for routine use in derivative transactions in the international capital markets. It was designed to promote certainty, and the significance and global nature of ISDA had been recognised by English courts.

(2) In the case of each of the swaps, the bank entered into a back-to-back hedging swap with a bank outside Italy in the international market using the same industry standard documentation.

387. In finding against the bank and holding that Art. 3(3) did apply, Walker J rejected both these points, saying at [211] that:

> "To my mind, Prato is right to say that both these points are misconceived. As to the master agreement, it is true that it is an international standard form, but it does not follow from this that it is an "element in the situation" which is connected to a country other than Italy. It is of course designed to promote certainty, but that does not give it a connection to a country other than Italy. Nor does the significance and global nature of ISDA. Even if the standard form itself were shown to have a connection with another country, that would not in the present case be an "element relevant to the situation" as it existed at material times. Throughout the relevant period everything relevant to the use of the form happened in Italy. As to Dexia's decision in each case to choose a non-Italian counterparty for its back to back hedging swap, that does not appear to me to be an element relevant to the situation as between Prato and

> Dexia. Whether or not Dexia entered into a hedging swap is a matter for Dexia alone: to Prato it is immaterial. There was no contemplation that a non-Italian entity would take over obligations of either party. Dexia's choice to use a non-Italian counterparty is something which is completely external to "the situation" at the time that choice of law was agreed."

388. The Transport Companies submit that this conclusion applies equally, pointing out that the facts are very similar to the present case, since Portugal was where both parties were incorporated, where the parties communicated with each other, where the swaps were entered into, and where the obligations under the swaps had to be performed (see *Dexia* at [209]).

389. BST, on the other hand, submits that elements of a 'non-domestic' or 'international' character which point outside Portugal should not be ruled out, whether or not such elements point towards a particular country. It further submits that it is not material whether a party is aware that the other party is hedging the swaps, and that the use of the ISDA Master Agreement and the existence of the back-to-back hedges are all elements of the situation which were not connected to Portugal.

(v) The court's conclusion as to the approach to the application of Art. 3(3)

390. As the Transport Companies say, a key difference between the parties on the Rome Convention issue is whether it is sufficient under Art. 3(3) to identify "international" factors, i.e. factors with no connection to a particular legal system, to take the case outside the article. BST says that it is, whereas they say that it is not.

391. This leads the Transport Companies to put their case in a particular way.

392. In their trial submissions, it was submitted that the question for the English court in determining whether Art. 3(3) applies in the present case is—"Is there any element linking the contractual dispute between BST and the Transport Companies to the legal system of a country other than Portugal, which the English Court would recognise as a connecting factor under its law of conflicts (other than the choice of law and jurisdiction clauses)?"

393. The contention that the court should be looking for connecting factors to a particular legal system is central to their case.

394. However, the court is not concerned to determine the applicable law—there is already a valid choice of law. The question is whether that choice takes effect subject to non-derogable provisions of domestic law. Where there is an express choice of law, there is no need to enquire as to connecting factors which would indicate the applicable law in the absence of an express choice. The court does not therefore accept the approach of the Transport Companies in this regard.

395. The wording of Art. 3(3) focuses on whether the "*situation*" is linked to one country only. The Transport Companies objected that BST has failed to define the term "situation". However, this is addressed in the *Caterpillar* case in the passage at [18] cited above, where was said that, "It is noteworthy that Article 3(3) refers to elements

'relevant to the situation' which is wider than 'elements relevant to the contract' ….". In the Rome I Regulation, the word "situation" rather than "contract" was retained[27].

396. In that regard, the words of the provision seem to be deliberately general, referring to *all elements relevant to the situation*. As noted earlier, this wording was the result of negotiation and compromise. In the court's view, there is no reason to limit it to elements which would point to the applicable law being that of *another* country.

397. The swaps were, as BST submits, concluded in an international market for such derivatives. The evidence shows that over the period in question MdL and MdP in particular entered into swaps with a range of international banks from different countries. BST was one of a number of banks competing for the business, and it was able to do so because it is a subsidiary of Santander in Spain, itself part of an international banking group. The Transport Companies submit there is no market in the sense of indicating a connecting factor to the legal system of another country. However, this is inherent in the context of the international capital markets, where the market operates because it is international, and it is why the parties' choice of law and dispute resolution mechanism is so important.

398. Documentation is of the essence of such transactions in the capital markets. A Portuguese Framework Agreement had been used for earlier swaps, but by the time of these transactions, the parties had switched to ISDA documentation. The evidence is to the effect that this was a mutual decision, and reflected the position as regards other banks.

399. Clearly, the fact that documentation is in the English language will not in itself carry any weight, and so far as BST submitted to the contrary, the court does not agree. However, the swaps were also expressed and confirmed in English. Further, it is significant that in relation to each of the swaps, the parties used the "Multicurrency-Cross Border" form of the 1992 ISDA Master Agreement rather than the "Local Currency-Single Jurisdiction" form. The use of this form is consistent with the other international elements of the dealings involved.

400. In the court's view, there are practical reasons for taking account of the documentation as an element in its own right. The use of this standard international documentation provides an orderly contractual structure, among other things facilitating both hedging and restructuring, which can be important for both or either of the parties. It also promotes legal certainty. If it is left out of account as an element in determining the application of mandatory provisions of domestic law, the prospect arises of different legal rules applying to the swaps and to the back-to-back transactions, which themselves may be, and in this case were, hedged[28]. There is no evidence that the Transport Companies were aware of the hedging arrangements, and there was no reason for them to be concerned with them. It is not suggested that there was anything unusual about such arrangements, which in this kind of transaction are (the evidence shows) entirely routine.

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[27] As noted above in the context of the comments of the Max Planck Institute on the European Commission's Green Paper.

[28] See above for the facts in this regard.

401. These points have been recognised by the courts in Portugal in the three recent decisions cited above. In the decision of the District of Lisbon Central Court of 14 July 2015 (538/14.2TVLSB) (*Sociedade de Desenvolvimento do Norte da Madeira v BST*), the court said in refusing to accept jurisdiction that, "… the adoption of the standard ISDA model contract is an element – par excellence – of the international nature of the interest rate swap contracts in the proceedings".

402. After the end of the hearing, there has been a further decision of the Supreme Court of 2 February 2016 (542/14.0TVLSB.L1.S1), which is the appeal in the first of the three cases noted above, in which the Supreme Court referred to the CJEU the question of whether a swap entered into on ISDA terms between two nationals of the same Member State has sufficient external or international elements to trigger the application of the Brussels Regulation.[29]

403. As a result, the Transport Companies say, this issue remains moot in Portuguese law. The court is content to proceed on this basis. (So far as the English jurisdiction is concerned, by reason of Article 2 to the First Protocol of the Rome Convention only the Supreme Court and "other courts from which no appeal is possible" have the power to refer. That does not include this court.)

404. In conclusion, the court finds as follows. For the purposes of Art. 3(3) of the Rome Convention, in determining whether, choice of law aside, all the other elements relevant to the situation are connected with one country only, the enquiry is not limited to elements that are local to another country, but includes elements that point directly from a purely domestic to an international situation. In financial transactions, the use of ISDA or other standard documentation used internationally may be relevant, and the fact that the transactions are part of a back-to-back chain involving other countries may also be relevant. Respectfully disagreeing with the conclusion in *Dexia v Comune di Prato* in these regards, the court considers that this approach is consistent with the authorities set out above, and specifically that the latter point is supported by the *Caterpillar* case and the commentary in *Dicey, Morris & Collins*.

405. It may be noted that there are other limitations on freedom of choice of law, for example in the case of consumer and employment relationships, and that provision is made for overriding mandatory provisions (now in Art. 9 of the Rome I Regulation), and a public policy (*ordre public*) exception (now in Art. 21 of the Rome I Regulation). Importantly in the present case, for reasons set out above the court's conclusion on Art. 3(3) does not affect the mandatory application of the relevant provisions of the Portuguese Securities Code, one of the functions of which is to implement EU directives that contain common rules applicable to financial services business.

The application of Article 3(3) on the facts

406. Applying the above approach, the next question is whether Art. 3(3) applies on the facts.

407. The Transport Companies' case is that the answer is obvious: this is not a case like *Caterpillar* (supra) with an American party, a French party, a loan to build a vessel in

[29] Notified to the court by email of 10 February 2016.

Singapore and a contractual provision for payments to a Singaporean builder. It is not a case like *Emeraldian* (supra) where the guarantor was a Chinese company, the beneficiary of the guarantor was a Liberian company, and the subject of the guarantee was an obligation under a charterparty governed by English law.

408. The case, they submit, is one of contracts between a Portuguese bank on the one hand, and a publicly-owned Portuguese transport company on the other. The obligations of both parties were to be performed in Portugal, the obligations were entered into in Portugal, the obligations under the contracts were not conditional on or otherwise affected by other contracts, and no other contracts were conditional on or otherwise affected by these contracts. There were no other parties to these contracts, no parties involved in the performance of their respective obligations under these contracts, and so the situation at the time of choice for each contract was a simple one. Accordingly, the Transport Companies submit, by Art. 3(3), provisions of the law of Portugal which cannot be derogated from by agreement apply to the swaps.

409. The "elements of the situation" relied on by BST to the contrary, and the court's opinion on each, are as follows:

(1) (i) In the Schedule to the Master Agreements, it was provided that BST "may assign and delegate its rights and obligations under any Transaction to any subsidiary of Banco Santander Central Hispano SA …" (i.e. Santander, Spain). BST says that this is a significant point of distinction from the *Dexia* case, in which the judgment records that, "There was no contemplation that a non-Italian entity would take over obligations of either party" (see the quotation set out above). Here, the possibility that one of the parties might end up being non-Portuguese was expressly contemplated. The Transport Companies respond that the terms of the contracts in the *Dexia* case are not known, but in the court's view the judgment makes the point sufficiently clear. More substantially, it is said that at the time of the conclusion of the contracts, there were no assignments, and it is suggested that BST's argument would lead to the conclusion that the only contracts that fall outside Art. 3(3) are those which are non-assignable.

(ii) The court's conclusion is as follows. At the time of contracting the bank had potential payment obligations over the long term, and so a right to assign was an important provision. The Transport Companies themselves point out that Santander Spain has numerous direct and indirect subsidiaries, including in the EU, UK, South America, USA and elsewhere. The effect was, therefore, that at the time of contracting, the contract allowed for substitution of a non-Portuguese bank for the Portuguese bank. This, in the court's view, is not a *potential* element relevant to the situation, as the Transport Companies argue, but an *actual* element relevant at the material time. It does not follow that the only contracts that fall outside Art. 3(3) are those which are non-assignable—the right to assign may be of limited or no significance depending on context. The significance of the bank's right of assignment in the present context is that the parties envisaged that performance over the substantial period (averaging 14 or so years) that the swaps covered could be by a *non-Portuguese* bank. This is not in the court's estimation consistent with the contract being seen as purely domestic.

(2) Under the Master Agreements, BST provided a UK address for service of process in any proceedings. In the court's view, this is irrelevant.

(3) Use of the "Multicurrency-Cross Border" form of the 1992 ISDA Master Agreement. The court's conclusion is that this is an element relevant to the situation which is not connected with Portugal: the parties' arguments and the court's reasoning is set out above.

(4) Though English is the language of commerce, and its use is not in itself significant (see above), it is of some relevance in the court's view that English was used to set out the terms of the swaps, and to confirm them. This contrasts with the fact that in their day to day dealings, the parties spoke and wrote in Portuguese.

(5) (i) BST says that it depended on its relationship with Santander Spain to offer and be able to enter into the swaps. It hedged its exposures under the swaps via back-to-back contracts on ISDA terms governed by English law with BSNP, which in turn entered into back-to-back contracts with Santander Spain. It relied on Santander Spain to price the swaps, which had to be approved by various Santander Spain product and risk committees before they could be concluded by BST with the Transport Companies, and perform the necessary risk calculations.

(ii) These facts are not disputed: in fact in a different context the Transport Companies emphasise the same points:

> "BST did not have the capabilities to sell complex derivatives on its own. It was dependent on Santander to price such derivatives, to calculate the credit risk exposure of the transactions (known as the "REC") and to hedge BST's market risk through back-to-back swaps. According to Ms Antunes, Santander's trading team gave BST "product capability" as it had a "centralised, bigger trading portfolio". There is no evidence, however, that the Transport Companies were aware of any of this."

(iii) The Transport Companies respond that the back-to-back BST contracts were with BSNP, also a Portuguese bank, that they were not aware of the arrangements, and that the authorities cited above and relied on by BST say nothing as to the degree to which "chain" or "string" contracts must be related. On this point, the court's view is that the interposition of BSNP does not affect the fact that in substance the hedging was with Santander Spain. As indicated above, there was no reason for the Transport Companies to be concerned with the arrangements, which in this kind of transaction are (as has been noted) entirely routine.

(iv) The court's conclusion is as follows. For reasons given above, the swaps and the back-to-back contracts with Santander Spain are related, and this is an element relevant to the situation which is not connected with Portugal. The fact that the participation of Santander Spain was necessary not just to approve

the transactions, but also to provide the capabilities to enable them, is also relevant.

(6) (i) The swaps were concluded in an international market for OTC[30] interest rate derivatives. The Transport Companies respond that BST considered itself to be operating in a Portuguese market. Overall, however, evidence shows that the market was an international one, and that international banks competed for the business. MdL concluded 165 swaps[31] with banks from the USA, Switzerland, the UK, Germany, France and Spain as well as Portugal, and these were on ISDA terms._MdP entered into 21 swaps with banks from Switzerland, France, Germany, the US, and Japan, and these were on ISDA terms. STCP concluded 2 swaps, one with BST and one with a French bank, presumably on ISDA terms. The 6 Carris swaps were with Portuguese banks, but 5 of them were on ISDA terms.

(ii) The court's conclusion is as follows. Overall, the facts clearly demonstrate that the BST swaps were anchored in a market that is necessarily international in its operation. This is an element relevant to the situation which is not connected with Portugal.

(7) The use of international references rates, that is, EURIBOR and LIBOR, is in the court's view largely irrelevant. These are standard interest rates, and equally consistent with the transactions being purely domestic, particularly since the euro is the currency of Portugal.

(8) Although BST has pointed to the fact that the notional amounts of some of the swaps were linked to various loans and other liabilities to non-Portuguese parties, they are independent contracts, and again in the court's view are largely irrelevant to the question for decision.

410. It has not been suggested by the Transport Companies that the position differs from swap to swap, and the court considers that there is nothing to differentiate them for the purposes of this issue.

411. Summarising the main points made above, because of the right to assign to a bank outside Portugal, the use of standard international documentation, the practical necessity for the relationship with a bank outside Portugal, the international nature of the swaps market in which the contracts were concluded, and the fact that back-to-back contracts were concluded with a bank outside Portugal in circumstances in which such hedging arrangements are routine, the court's conclusion is that Art. 3(3) of the Rome Convention is not engaged because all the elements relevant to the situation at the time of the choice were not connected with Portugal only. In short, these were not purely domestic contracts. Any other conclusion, the court believes, would undermine legal certainty.

[30] Over the counter.
[31] This number includes restructurings.

Whether Art. 437 of the Portuguese Civil Code is a "mandatory rule"

412. Given this conclusion, the second issue does not arise, but it was fully argued and the court should express its view. The issue is whether Art. 437 of the Portuguese Civil Code is a "mandatory rule" within Art. 3(3) as a provision which cannot be derogated from by contract. The court's conclusion is set out below in the context of the discussion of Art. 437 where the issue arises.

PART G: THE "GAME OF CHANCE" ISSUE

Introduction

413. The Transport Companies' case is that the swaps are unlawful "games of chance" by virtue of being purely speculative instruments and thus unlawful bets, with the consequence that they are void under Art. 1245 and/or Art. 280 and/or 281 of the Portuguese Civil Code.

414. The court has held that Art. 3(3) of the Rome Convention is inapplicable, and on this basis it is common ground that the "game of chance" issue does not arise. However, the issue was argued, and the court should express its opinion.

415. If to the contrary it does arise, it is common ground that the relevant provisions of the Civil Code are mandatory.

416. BST's case is that even if Art. 3(3) of the Rome Convention were engaged these provisions would have no application to business transactions contracted between a bank and its counterparties, and the swaps would not, in any event, fall foul of them.

417. It is not suggested by the Transport Companies that the result differs under any of the three articles of the Civil Code that they rely on. In other words, it is common ground that the arguments are the same on each, and they stand or fall together.

418. The "game of chance" issue was the issue that received least attention in oral closings. The Transport Companies simply referred to their written closings, adding nothing orally at all.

419. It is to be inferred that this is because (although they do not accept this) recent decisions of the Portuguese courts point in a clear direction on this issue.

420. Consequently, the Transport Companies' written closing submissions focus on drawing a distinction with the position before and after the implementation in Portugal of MiFID the effective date of which was 1 November 2007 (see below).

421. All the swaps were executed prior to 1 November 2007, and so pre-MiFID, except the STCP swap with a trade date of 2 November 2007.

422. On this basis, they seek to distinguish in particular a decision of the Supreme Court of Portugal of 11 February 2015.

The relevant provisions of the Civil Code

423. The relevant provisions of the Civil Code (CC) are as follows.

424. Art. 1245 CC provides:

> "Games and betting are not valid contracts and do not give rise to civil obligations; however, when lawful, games of chance give rise to natural obligations, except where by other motives they shall be deemed void or voidable pursuant to the general law, or, if the creditor has committed fraud in its execution."

425. Article 1245 sits within Chapter XV of the CC, entitled "Gaming and betting" (*CAPÍTULO XV Jogo e aposta*). Article 1245 itself is headed "Nullity of contract" (*Nulidade do contrato*).

426. Arts. 280 and 281 CC provide:

> "280 Requirements of the contractual object
>
> 1. A contract whose object is physically or legally impossible, contrary to the law or indeterminable, is null.
>
> 2. A contract which is contrary to *ordre public* or offensive to *boni mores* is null.
>
> 281 Purpose that is against the law or public order or offends good practice
>
> If only the purpose of the legal transaction is against the law or public order, or offends '*boni mores*', the transaction will only be void when the purpose is common to both parties."

The parties' contentions

427. The Transport Companies' case is that the swaps, being in substance speculative transactions, or as it was put in closing submissions "purely speculative swaps", and not effective risk management instruments, are unlawful games of chance and/or contrary to Portuguese *ordre public.*

428. The Transport Companies rely on the evidence of Professor de Freitas who states that "when … swap contracts do not play [the function of "managing, hedging or controlling interest rate risk fluctuation"] and are used exclusively to speculate … the provisions of Art. 1245 of the CC in principle will apply".

429. Prof. de Freitas considers that where "(i) swaps created [risk], rather than operated as an antidote to risk and (ii) that the margin of risks assumed by the parties was dramatically imbalanced", they are both contrary to Art. 1245 CC and Art. 280 and, in the present case, additionally Art. 281 of the CC.

430. Relying on the evidence of Professor Câmara, BST contends that Art. 1245 of the CC (it being common ground that the same arguments apply to the other provisions) does not apply to the swaps because:

(1) Entering into derivatives transactions, even for the purposes of financial speculation, is a distinct type of activity that does not constitute gaming or betting within the meaning of Art. 1245;

(2) Speculation is a legitimate purpose of financial transactions, including swaps;

(3) Reducing financing costs is also a legitimate purpose of financial transactions, including swaps;

(4) Art. 1247 CC expressly disapplies Art. 1245 where the transaction or contract in question is subject to other specific legislative provisions. Technically and conceptually, therefore, Art. 1245 does not apply to business transactions concluded by banks which are regulated under the Securities Code, which provides special legislation by way of a regulatory regime that is incompatible with derivatives being games and bets.

The experts

431. The Transport Companies' second Portuguese law expert, Professor de Freitas, gave evidence on the 'game of chance' issue. His background is in procedural law, but (as the Transport Companies say) he is a leading proponent in Portugal of the position that speculative financial instruments are unlawful under Portuguese general law. Though that has been accepted by the Portuguese Supreme Court in one judgment (that of 29 January 2015) it has not been accepted in another (that of 11 February 2015).

432. The Transport Companies say that Professor Câmara, by contrast, has played no part in this debate in Portugal and is not an expert (on either side of the debate) in this area of law.

433. However, it is common ground that he is an expert in securities law, and an important aspect of this issue relates to how the Securities Code rules on contemporary financial instruments such as swaps interact with older rules on gaming and betting.

434. Indeed, the Transport Companies make this point in their closing submissions. Citing the questions posed in the English case of *Westdeutsche Bank v Islington LBC* [1996] AC 669 to do with swaps and wagers, they say:

> "The question for this Court in substance is whether the same is true of Portuguese law, with this difference. Portuguese law has no equivalent of s. 10 of the [UK] Gambling Act 2005 or s. 63 of the [UK] Financial Services Act 1986 [which exclude swaps from the gaming laws]. The answer to the question therefore depends on whether it can be said that the Portuguese Securities Code (in its different iterations) has displaced the Portuguese mandatory law provision regulating "gaming and betting" ("*jogo e aposta*"), namely Art 1245 of the Civil Code."

435. The "question in substance" goes not least to how European principles have been implemented in the Portuguese Securities Code.

436. Further, there is the question of the way the Portuguese courts have decided cases since these two decisions of the Supreme Court and whether this amounts to a trend. Whilst paying tribute to Professor de Freitas, who is eminent, and whose evidence was valuable, the court tended to prefer that of Professor Câmara on this quite narrow issue.

The jurisprudence

437. Leaving aside decisions of the lower courts where cases went to the Supreme Court, there are seven relevant decisions, the swaps being in some cases pre- and in some cases post MiFID. None involved snowball swaps:

(1) Decision of the Lisbon Court of Appeal of 21 March 2013 (2587/10.0TVLSB.L1-6): pre-MiFID. It concerned a 5-year swap which related to a 3-year underlying loan. The Court held that a swap is not a 'derivative' under the Securities Code unless its notional matches, for the swap's duration, the principal of an underlying liability of one of its parties. It held that that the swap was not a regulated derivative but an unenforceable bet.

(2) Decision of the Supreme Court of Justice of 29 January 2015 (531/11.7TVLSB.L1.S1): post-MiFID. The majority of the Court held that although the swaps were said to have a "risk management" purpose, the absence of reference to a financial operation or to a portfolio of such operations by way of hedging (together with other factors) meant, using the typology of an eminent commentator, Professor Cordeiro, that these swaps amounted to "... a pure bet over interest rates ...". Professor Cordeiro's view is that, "In fact, in interest rate swaps, there are two distinct situations: swaps which make a rational management of interests due to any existing loan and *ad nutum* swaps, which do not have anything to do with underlying loans". The latter are to be treated, he says, as bets.

(3) Decision of the Supreme Court of Justice of 11 February 2015 (309/11.8TVLSB.L1.S1): post-MiFID. Unlike in the previous decisions, the Court upheld the lawfulness of the swap, though the parties differ as to the interpretation of the decision. Broadly, the Court decided that swaps are valid whether or not the parties have underlying liabilities, that speculation may be a legitimate market activity and is different from gambling, and that the regulation of swaps under MiFID displaces general law, including by reference to Art. 1247 CC which disapplies Art. 1245 where the contract in question is subject to other specific legislative provisions.

(4) Decision of the Lisbon Court of Appeal of 2 July 2015 (2118-10.2TVLSB.L1.-2): pre-MiFID. It is common ground that the Court considered doctrine including the views of Professor de Freitas, but adopted the reasoning of the Supreme Court in its decision of 11 February 2015:

> "Also the Supreme Court in its aforesaid judgment of 11/2/2015, proceedings number 309/TVFLSB11.8L1.S1, understood that it is not possible to consider swaps as a game of chance.

> Adhering to the argument that we have already set out above, we likewise understand that we are not faced with a game of chance agreement, wherefore the consequences presented by the appellant do not verify."

(5) Decision of the Porto Court of Appeal of 15 September 2015 (29/14.1TVPRT.P1): pre-MiFID. The Court held that the swap was valid on the basis that there was an underlying transaction, but Professor de Freitas accepted that the decision "trends towards" the 11 February 2015 Supreme Court decision.

(6) Decision of the Porto Court of Appeal of 28 October 2015 (27/14.5TVPRT.P1): post-MiFID. This was a case in which the swap had no direct relationship with the loan. The court expressly followed the judgment of the Supreme Court of 11 February 2015.

(7) Decision of the Supreme Court of Justice of Justice of 26 January 2016[32] (876/12.9TVLSB.L1): post-MiFID. The majority expressly followed the judgment of the Supreme Court of 11 February 2015 (the dissenting judge did not express a conclusion on this part of the case).

438. Although (so far as is recalled) this was not mentioned at trial, BST had applied for permission to invoke a special appeal procedure in respect of the Supreme Court judgment of 29 January 2015 asserting that it conflicted with the Supreme Court judgment of 11 February 2015. After the end of the hearing in the present case but before judgment was handed down, BST's application was rejected by a single judge of the Supreme Court on 12 January 2016. It was held that the requirements for the special appeal process were not satisfied because there were important differences between the factual matters of the two judgments.

Discussion and conclusion

(a) Pre and post-MiFID

439. BST submits that even where Art. 1245 could apply to swaps, the fact that swaps are regulated by the Securities Code demonstrates that swaps are subject to "special legislation" for the purposes of Art. 1247 CC, and so Art. 1245 does not apply to swaps for that reason. This applies to both pre and post-MiFID swaps.

440. The Transport Companies submit that:

(1) The pre-MiFID Securities Code itself provides no definition of a swap, and is not an "exceptional" law, incompatible with Art. 1245 of the Civil Code.

(2) The cases dealing with pre-MiFID swaps contain no discussion as to whether the pre-MiFID Securities Code displaced the general law.

(3) In accordance with the general law (and the writings of Professor Ascensão, Professor Cordeiro and Professor Ferreira de Almeida, which the evidence of

[32] This case was decided after the hearing and was the subject of written submissions from the parties. The parties agreed that there would be no Portuguese law expert evidence on the meaning of this decision.

Professor de Freitas supports, and Portuguese jurisprudence), and subject to the correctness of the Transport Companies' analysis of the 11 February 2015 Supreme Court decision, swaps that are not hedges but are speculations are void bets pursuant to Art 1245 of the Civil Code because they lack a "cause".

(4) The "cause" of the contracts means whether they had a "ground" that is "legally relevant and legitimate".

(5) The judgments dealing with post-MiFID swaps simply extend and amplify what might be a valid "cause" for a swap, i.e. that it is not a necessary requirement that the swap should be referable to a particular loan for it to have a valid cause.

(6) In upholding the validity of speculation, the distinctions the Supreme Court drew in the judgment of 11 February 2015 between a bet and a speculation "do not withstand scrutiny", because recreation is not an essential component of gambling, and it is doubtful how rational the forecast of future interest rates ever is, and to state that the swap contract is performed "within the context of the market" simply begs the question.

(7) The Supreme Court in the 11 February 2015 judgment did not eliminate the possibility (absent the Securities Code being regarded as a special law applying to all swaps of whatever type) of purely speculative swaps being a "differential contract on the borderline of gaming and betting".

(8) Because the eight pre-MiFID Swaps are not hedges and/or do not perform any proper financial management function for the reasons the Transport Companies give which are set out at in Part C of this judgment, they are void in Portugal.

(9) In any event, the Portuguese court would look at the facts, and in the present case is more likely to apply the judgment of the Supreme Court of 29 January 2015 to the swaps.

(10) As to the one post-MiFID swap (the STCP swap) the Transport Companies rely on the majority judgment of the Supreme Court of 29 January 2015, because the MiFID Securities Code, whilst expressly referring to swaps for the first time, still does not contain any definition of swaps, in particular by reference to their socio-economic function or cause: on that basis, even the STCP swap (which is post-MiFID) is void.

441. The court upholds BST's submissions as supported by Professor Câmara because:

(1) The pre-MiFID Securities Code reflected the Investment Services Directive (ISD) which was the predecessor to MiFID, and includes a reference to "derivative financial instruments".

(2) The ISD covered interest rate swaps—the fact that it did not define them makes no difference.

(3) Although as the Transport Companies point out, the ISD is a minimum harmonisation measure, the structure and purpose of the pre and post MiFID Securities Code are very much the same.

(4) As BST says, it would be odd to treat one as an exceptional law and not the other.

(5) There is no public policy ("general good") reason identified for drawing a distinction.

(6) There is some limited[33] support for BST's position in Art. 333(1) of the Securities Code.

(7) Although the Lisbon Court of Appeal decision of 21 March 2013 drew a distinction between the position pre and post MiFID, this is to be seen against its later decision of 2 July 2015 and the Porto Court of Appeal decision of 15 September 2015, both of which applied the decision of the Supreme Court of 11 February 2015 to pre-MiFID swaps.

(8) Although the Transport Companies criticise the reasoning in the Supreme Court decision, it contains a detailed analysis of why swaps are not gaming contracts, and it has been followed by the courts since.

(9) Professor Câmara's opinion is that there is a "growing trend" against the application of Art. 1245 to swaps.

(10) This is confirmed by the majority decision of the Supreme Court of Justice of 26 January 2016 decided after the hearing in this case ended.

(11) The narrow construction as to "cause" placed on the decision of 11 February 2015 by the Transport Companies is not supported in the Court's reasoning or in the evidence.

(12) In any event, the swaps did have underlying transactions, and the narrow construction does not point to a different result.

(13) The swaps were not, in Professor Cordeiro's words, an *ad nutum* bet on interest rates.

(14) Although none of the decided cases involved snowball swaps, the principle is the same.

(15) There can be no real argument as to the effect of Art. 1247 CC on the STCP swap which is post-MiFID.

[33] As the Transport Companies say, some relevant words were omitted from Professor Câmara's quotation from the provision. The court agrees with the Transport Companies that BST gets no support from Portugal's pre-MiFID implementation of the Community rules on collective investment schemes, which come from a different regime.

(b) The swaps had a non-speculative purpose

442. It is correct as the Transport Companies say that there has been a debate in the writings of distinguished commentators such as Professor Ascensão, Professor Cordeiro and Professor Ferreira de Almeida as to whether it is appropriate to treat speculative swaps as a bet as opposed to those with a purpose such as hedging.

443. However, the effect of the decision of the Supreme Court of 11 February 2015 is to treat speculation in the context of financial dealing as a legitimate activity different from gaming.

444. The decision is consonant with English law decisions cited above which find it impractical to try to distinguish between speculation and hedging in the financial context in the absence of an applicable definition.

445. In any event, as BST says, the result of the decision as applied subsequently is that the Transport Companies' contention based on the proposition that the swaps were purely speculative instruments does not get off the ground.

446. BST has an alternative submission as follows.

447. The decision of the Supreme Court of 11 February 2015 expresses different purposes for swaps which are legitimate.

448. The Court held that interest rate swaps have three purposes: "reduction of the risk of variation of the interest rates; possibility of taking advantage of better rates; speculation on their variation".

449. BST submits that the swaps have a legitimate purpose in reducing financing costs. It submits that the swaps in this case fall directly within the second purpose identified. Reducing financing costs is an accepted function of interest rate swaps.

450. This submission is disputed on the facts by the Transport Companies, their case being that the swaps did not operate to reduce interest rates and were dramatically imbalanced and created risk rather than managed it.

451. However, Professor de Freitas did accept that if a swap is intended to permit a party to exploit the possibility of obtaining a reduction on the interest rate which it pays on existing borrowings, that is not a purpose which makes the swap invalid.

452. This dispute is covered in Part C above, and the court agrees with BST for the reasons set out there. Nothing relating to the asserted "dramatic imbalance" so far as this was developed in closing submissions affects this conclusion.

(c) Conclusion

453. For the above reasons the court accepts BST's submissions, finding that:

(1) The swaps were not betting or gaming and are not invalidated on this ground.

(2) The swaps fall within the remit of the Securities Code, and thus outside the scope of Art. 1245 by virtue of Art. 1247.

(3) The purpose of attempting to reduce the Transport Companies' financing costs is a recognised and valid purpose for an interest rate swap.

(4) Even if it were established that the swaps were 'purely speculative', the recent cases support the view that speculation is not an illegitimate activity and that entering into interest rate swaps, being a regulated activity, is not gaming or betting.

(5) It is common ground that a different result does not result under Arts. 280 and 281.

(6) In the circumstances, the court need make no finding on BST's submission that the swaps are classified as "natural obligations", nor as to the effect of any representations made to BST in the ISDA Master Agreements (see *Dexia Crediop S.p.A. v Comune di Prato* [2015] EWHC 1746 (Comm) at [250]).

PART H: THE ABNORMAL CHANGE OF CIRCUMSTANCES ISSUE

Introduction

454. The contention that there has been a fundamental change in circumstances since the swaps were contracted with the result that they cannot in good faith be enforced by the bank was the most extensively argued part of the case.

455. Portuguese law provides for this kind of situation by an article in the Civil Code that applies where there has been an "abnormal change of circumstances". The provision follows in the tradition of the *rebus sic stantibus* doctrine in civil law. It has been relied on by the Transport Companies in defence.

456. On the above findings, the defence is not open, because Art. 3(3) of the Rome Convention is inapplicable, and on this basis it is common ground that English law applies. (The parties have not raised what the position would be under English law.) But the position under Portuguese law having been fully argued, the court will make findings accordingly. To invoke the defence, the Transport Companies need to show that the relevant provisions are non-derogable so as to prevail notwithstanding the choice of English law.

457. The defence is raised in relation to seven of the nine swaps: it does not apply to the second Carris and Metro Porto swaps (Carris 2 and MdP 2). This is because one had a different formula for calculating the spread and the other had an upper but not a lower barrier. It is the combination of a spread which is cumulative and the prolonged breach of the lower barrier activating the spread that has resulted in such high rates for the other swaps.

458. The spread on both these swaps as at 1 October 2015 was zero, so that Carris and Metro Porto are only paying the fixed rate. In effect, therefore, they are in the same position as a party to a vanilla swap. It is accepted by the Transport Companies that this factual distinction puts them outside the ambit of this defence.

Rebus sic stantibus and Art. 437 of the Civil Code

459. Professor da Frada explains the origins of the *rebus sic stantibus* doctrine in the civil law tradition, saying that the doctrine rests on a theory concerning the parties' will. He further expresses the opinion that there has been a shift towards an objective theory of contractual justice and good faith. It is common ground that it is an institution of ancient roots in Portugal, though not specifically incorporated in Portugal's 1847 Civil Code. Influenced by the German "basis of the agreement" doctrine, it was incorporated in its present form in the 1966 Civil Code, the drafting of which was chaired by the leading jurist Professor Adriano Vaz Serra. However, Professor da Frada opines that it encompasses multiple elements and influences, and does not only reflect German legal theory.

460. Article 437(1) of the Civil Code provides:

> "437 Abnormal change in circumstances
>
> 1. If the circumstances on which the parties based their decision to enter into a contract have undergone an abnormal change, the injured party is entitled to termination of the contract or to modify it in accordance with principles of equity if fulfilment of that party's obligations under the contract would be a serious breach of the principles of good faith and if the abnormal changes do not form part of the risks covered by the contract.
>
> 2. If termination is requested, the counterparty may oppose by stating that it accepts modification of the contract in accordance with the previous paragraph."

461. The expert evidence on this issue was provided by Professor da Frada (for the Transport Companies) and Professor Câmara (for BST). They agree that the application of Art 437 is dependent on:

(1) There being a change in the circumstances on which the parties based their decision to enter into a contract;

(2) The abnormal character of such a change;

(3) That such abnormal change would result in a serious breach of the principles of good faith if the injured party was required to fulfil its obligations under the contract; and

(4) The abnormal change not falling within the risks covered by the contract.

Each of these factors is addressed below.

The parties' contentions summarised

462. It is the Transport Companies' case that: (a) Art. 437 is a mandatory rule of Portuguese law; (b) the changes to interest rates, and their maintenance at record lows since the second quarter of 2009 amount to and are the consequences of an abnormal

change to the circumstances on the basis of which the parties entered the swaps; (c) that abnormal change does not form part of the risks covered by the swaps; (d) as a result, requiring the Transport Companies to continue to perform their obligations under the swaps would be a serious breach of the principles of good faith; and (e) accordingly, the Transport Companies are entitled to the termination of the swaps.

463. BST submits that Art. 437 CC has no application in the present case even if Art. 3(3) of the Rome Convention is engaged. This is because (a) Art. 437 is not a mandatory rule; (b) even if Art. 437 could apply, there has in any event been no "abnormal change" in the circumstances on which the parties based their decision to enter into the swaps, within the meaning of Art. 437; (c) in any event, any such abnormal change forms "part of the risks covered by the contract"; and (d) fulfilment of the Transport Companies' obligations under the swaps would not be a "serious breach of the principles of good faith".

464. Accordingly, (as summarised by the Transport Companies and not in dispute) the key issues are:

(1) Is Art. 437 a mandatory rule of Portuguese law within the meaning of Art. 3(3) of the Rome Convention?

(2) What were the circumstances on the basis of which the parties entered the swaps?

(3) Has there been an abnormal change in the circumstances on which the parties based their decision to enter the swaps?

(4) Whether, if there has been an abnormal change, that change forms part of the risks covered by the contract.

(5) Whether requiring the Transport Companies to continue to perform their obligations under the swaps would be a serious breach of the principles of good faith.

(6) Whether the Transport Companies are entitled to termination of the swaps and, if so, from what date(s), or modification. The possibility of modification arises from Art. 437(2).

The issues

(1) Whether Art. 437 is a "mandatory rule"

(i) The court's approach to the question

465. The issue is whether Art. 437 of the Portuguese Civil Code is a "mandatory rule" within Art. 3(3) of the Rome Convention as a provision which cannot be derogated from by contract.

466. As explained above, the reference to "mandatory rules" is omitted in Art. 3(3) of the Rome I Regulation. Recital 37[34] indicates that this is to distinguish the concept of "overriding mandatory provisions" (dealt with in Art. 9) from the expression "provisions which cannot be derogated from by agreement" which is the subject matter of Art. 3(3)[35]. However, Recital 15 to the Regulation makes clear that "no substantial change is intended as compared with Article 3(3)" of the Convention.

467. Whether or not the rule is "mandatory" in this sense is a matter of domestic law, here the law of Portugal. The approach stated by the CJEU in the *Unamar* case (supra) at ¶50 in the context of Art. 7 of the Rome Convention also seems to be pertinent as regards Art. 3(3) ("It is … for the national court, in the course of its assessment of whether the national law which it proposes to substitute for that expressly chosen by the parties to the contract is a 'mandatory rule', to take account not only of the exact terms of that law, but also of its general structure and of all the circumstances in which that law was adopted in order to determine whether it is mandatory in nature …").

468. However, beyond that, there is the question as to what is meant by "rules which cannot be derogated from by contract". What is the meaning of this phrase? In closing submissions, BST suggested that this is an English law question, incorporating principles of European law and customary international law. The court prefers the Transport Companies' submission that this is a question to be determined in accordance with the principles of interpretation of the Rome Convention set out above.

469. Nevertheless, the word "derogate" has to be given a meaning in this context, and neither party has cited an authoritative statement in that respect. In closing submissions, BST submits that 'derogate' does not only mean 'disapply entirely in all circumstances': parties may derogate from a contractual rule simply by cutting down its scope of application, by agreement[36]. The Transport Companies objected that this was a "novel filter", resulting in the screening out of some rules which are mandatory in domestic law, thereby defeating the purpose of Art. 3(3).

470. However, there is no reason why this objection should necessarily be correct. Context is important, as the passage from the *Unamar* case cited above shows. The term "derogate" has to be read in the light of the rule in question, but subject to that, the court agrees with BST's submission in this regard, which is that to "derogate from" is not the equivalent of to "oust" completely, as the Transport Companies appeared to submit.

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[34] "Considerations of public interest justify giving the courts of the Member States the possibility, in exceptional circumstances, of applying exceptions based on public policy and overriding mandatory provisions. The concept of 'overriding mandatory provisions' should be distinguished from the expression 'provisions which cannot be derogated from by agreement' and should be construed more restrictively."

[35] See also the explanation in Plender and Wilderspin, *European Private International Law of Obligations* (4th ed, 2015) at ¶6-060.

[36] BST cites the 'The Oxford English Dictionary' (2nd ed, 1989) ('OED') as giving the following relevant uses of the verb in modern English: "To take away (something from a thing) so as to lessen or impair it"; and "To take away a part from; ...". The verb is said to derive from the Latin, 'derogare', meaning: "to repeal in part, take away or detract from, diminish, disparage". Similarly, the first use given by the OED for the noun 'derogation' is: "The partial abrogation or repeal of a law, contract, treaty, legal right, etc.". The OED notes that in Latin the noun is "used only in the sense 'partial abrogation of a law'".

471. An important further dispute is whether the fact that Art. 437 CC can be waived *ex post* is decisive. It is common ground that the parties can agree after the abnormal change of circumstances has happened that they will not invoke Art. 437. The dispute is as to whether the article can be waived *ex ante*, and though the Transport Companies accept that provision can be made for risks *ex ante*, this is not they say to the extent of excluding Art. 437 entirely.

472. The core of the dispute between Professor da Frada and Professor Câmara, as explained in more detail in the following paragraphs, is that the former is of the opinion that Art. 437 is a mandatory rule of Portuguese law because it is grounded in good faith, and cannot be excluded altogether. Professor da Frada's opinion that good faith is a core value of the Portuguese legal system is not in dispute. Professor Câmara, whilst recognising the importance of the principle of good faith in Portuguese law, considers that it plays a limited function within Art. 437, coming into play if to require performance would be a serious breach of the principles of good faith.

(ii) The parties' contentions

473. The Transport Companies contend that their case that Art. 437 is a mandatory rule is supported by their expert evidence. This is principally in the light of (a) the underlying rationale of the provision (as preventing substantively unfair legal situations, which would otherwise be contrary to good faith) and (b) its modern juridical basis (resting on an objective theory of contractual justice rather than on a theory concerning the parties' will).

474. The former is relevant because, were it possible for parties to agree to opt out of Art. 437 in its entirety, they would be agreeing to opt out of a core value of the Portuguese legal system, which self-evidently is not permissible, unless expressly provided for. The latter is relevant because it demonstrates that Art. 437 is not an exception to party autonomy, but the expression of a countervailing legal principle of Portuguese law.

475. BST contends that Art. 437 is plainly a non-mandatory rule however Art. 3(3) is interpreted. It contends that: (1) It suffices under Art. 3(3) that a rule can be waived by agreement of the parties after circumstances have arisen which allow one or other of the parties to rely upon it (*ex post* waiver). This is material because, in the present case, it is undisputed that Art. 437 can legitimately be subject to *ex post* waiver as a matter of Portuguese law. (2) If however Art. 3(3) requires that the parties be able to derogate from the rule before it becomes engaged (*ex ante* waiver), BST submits that the parties may also derogate from Art. 437 in that way as a matter of Portuguese law.

(iii) The jurisprudence (case law)

476. As is the position in England and elsewhere, swaps transactions have been contentious before the Portuguese courts, and the application of Art. 437 has been considered where contracts have been affected by the fall in interest rates after 2008.

477. In the present context—i.e. mandatory or non-mandatory under Art. 3(3)— there is however (and unsurprisingly) no decision of the courts which is directly in point.

478. Professor Câmara and Professor da Frada each cite decisions of the Supreme Court in support of their opposing positions: these are the Supreme Court of Justice decision of 10 October 1984 (process number 71 834)), and the Supreme Court of Justice decision of 18 January 1996 (JSTJ00027759).

479. The court accepts the evidence of Professor da Frada that the later decision is the more significant.

480. This is because the Supreme Court refers to the writing of a leading jurist, Professor António Menezes Cordeiro, who speaks of Art. 437 as having a "control function". Considerable reliance is placed by the Transport Companies on the use of this term.

481. (Professor da Frada also refers to a decision of the Supreme Court of 27 January 2015 (876/12.9TBBNV-A.L1.S1), which in the context of Art. 437 refers to the "dialectical" conflict between the principles of party autonomy and good faith, however the case does not appear to cast much light on the Transport Companies' contention that Art. 437 should not be treated as an exception to party autonomy.)

482. The Transport Companies do not dispute that parties can make specific provision for risks. Their major point comes from decisions in the factual context of swaps.

483. They (and both experts) refer to three decisions of the Portuguese courts in which the potential application of Art. 437 to swap agreements has been recognised: the Supreme Court judgment of 10 October 2013 (1387/11.5TBBCLG.G1.S1), the Lisbon Court of Appeal judgment of 15 January 2015 (876/12.9TVLSB.L1-6)[37], and the Lisbon Court of Appeal judgment of 28 April 2015 (540/11.6TVLSB.L2-1).

484. It is important to note that these decisions are fact-sensitive, which is not in dispute. The decision of the Supreme Court of 10 October 2013 was in particular subjected to analysis. It was there stated that "… it would go against the principles of good faith that only the plaintiff bore adverse impacts [of the financial crisis]". Professor da Frada's writings among others are referred to in the Supreme Court's judgment.

485. The Transport Companies contended in closing that the effect of the decision is that the courts in Portugal have recognised the mandatory nature of Art. 437. They contend that "it is of the essence of an interest rate swap that it makes provision for every possible change in the relevant reference rate", and, the argument continues, it follows that "… on a formal basis, the parties to a swap will have provided in advance by contract for the risk of changes to interest rates. Thus, if (as BST contends) Art. 437 were subordinate to the principle of party autonomy, there would be no scope for the application of Art. 437 where the relevant change in circumstances is a change in the relevant interest rate. But this is not the case. The Portuguese courts have recognised that Art. 437 applies even to changes to interest rates in swap agreements, thus implicitly accepting the article's mandatory nature".

486. BST says that Professor da Frada did not himself draw this inference in his evidence on the decisions. Though the courts were of course concerned to enquire whether the abnormal circumstances were within the risks covered by the contracts, it was not

[37] Upheld by the Supreme Court in its decision of 26 January 2016.

suggested that the parties were not free to include within the contract whatever risks they saw fit. The submission is not, BST says, grounded in the expert evidence.

487. The court agrees with BST in this regard. Professor da Frada's evidence, in which he analyses the three decisions, points out that in the last of them (the Lisbon Court of Appeal judgment of 28 April 2015) the Court says that the risks covered by the contract were exceeded by "a very large measure". Further, the contention has to be read with the Transport Companies' case that the long period of near zero interest rates after 2008 did not form part of the risks covered by the contract.

488. The straightforward point is that none of the decisions show that the Portuguese courts have treated Art. 437 as non-derogable, or were in any way concerned with that issue. These are important decisions in the context of the applicability of Art. 437, but they do not bear on the question whether the provision is "mandatory" under Art. 3(3) of the Rome Convention.

(iv) Doctrine

489. The Transport Companies submit that their case is supported by leading (although they accept not universal) Portuguese doctrine, and in particular, the views of:

(1) Professor Vasconcelos, who (it is common ground) is a highly respected authority in the field of private law: in the eighth edition (2015) of his *Teoria Geral Do Direito Civil*, he says that, "Only when lacking a contractual solution which results from the agreement itself one can resort to article 437 of the PCC. Notwithstanding, article 437 does not cease to be mandatory". This is a clear statement—on the other hand, inevitably (as BST says) its weight is affected by the fact that Professor Vasconcelos had been retained by the Transport Companies as their Portuguese law expert. (He had to retire from that role due to ill-health.)

(2) Professor Cordeiro, as expressed in his 2001 edition of his book on "Good Faith in Civil Law" ("*Da Boa Fe no Direito Civil*"). Professor Cordeiro is also a leading commentator, and he says that "the reference to risk, which appears in art. 437/1, indicates the supplementary nature ["*natureza supletiva*"] of the alteration in circumstances. But this relationship of complementarity ["*relação de supletividade*"] must not be understood in absolute terms: the interpretation of those norms which establish penalties for the specific allocations of risk or such like must reveal whether the attribution being made is definitive, full, or whether even here it is admissible that, beyond a certain boundary, enforcement of contractual duties may contradict 'seriously the principles of good faith'. This therefore constitutes the second role, a control function".

(3) The reference to Professor Cordeiro's views in the decision of the Supreme Court of Justice 18 January 1996 has already been noted. In similar terms, Professor Cordeiro also refers to the "*nihil obstat*" of good faith.

490. Professor Câmara suggested in cross-examination that the word "*supletiva*" in this passage means "non-mandatory". However, as the Transport Companies put it, the material before the court shows that the word "*supletiva*" is polysemic, and its meaning depends on context. It has been variously translated (in agreed translations)

as "supplementary" and "non-mandatory", and in Professor Câmara's own words, as "default".

491. The court agrees with the Transport Companies that the word does not have the single sense of "non-mandatory", as indeed is plain from the passage quoted from Professor Cordeiro's book, and that the use of the word is not determinative in the context of Art. 3(3) of the Rome Convention.

492. Professor Câmara also said in evidence that in subsequent writings, Professor Cordeiro had qualified this expression of his views. BST relies on this to submit that Professor Cordeiro now "consigns Art. 437 to a derogable regime that applies only when the parties have not agreed an alternative regime".

493. The court agrees with the Transport Companies supported by the evidence of Professor da Frada that, when read in full, the passages in the later writings relied upon do not materially alter the meaning of Professor Cordeiro's views on Art. 437 as expressed in the passage above.

494. As regards commentary in general, BST submits that the commentary supports the evidence of Professor Câmara that Art. 437 is non-mandatory and may be derogated from by agreement.[38] It relies on the writings of Professor Luis Carvalho Fernandes and other commentators, but the most clear is that of Professor Mário Júlio de Almeida Costa who says in his *Direito das Obrigações* (2006): "The risks inherent to the type of contract in question must be treated, as it seems obvious, in the same way as the risks specifically covered by the parties in the concluded contractual agreement. It is possible for the contracting parties to waive or limit the application of art 437, [by/thus] assuming greater risks".

495. As Professor Câmara says, this commentator seems to express the opinion that Art. 437 can be waived, which is inconsistent with its mandatory nature. There is no force in the Transport Companies' objection that Professor de Almeida Costa is a former director of Banco Totta & Açores (now BST). The book was published long before the dispute as to the swaps arose, and there is no reason to regard it as other than an independent expression of views.

(v) The experts' arguments

496. In the opinion of Professor da Frada, the mandatory nature of Art. 437 is a result of (a) the underlying rationale of the provision (as preventing substantively unfair situations, which would otherwise be contrary to good faith) and (b) its modern juridical basis (resting on an objective theory of contractual justice rather than on a theory concerning the parties' presumed will). If it were it possible for parties to agree to opt out of Art. 437 in its entirety, they would be agreeing to opt out of a core value of the Portuguese legal system.

497. He accepted that the parties can make specific provision for risks—and that can be done not only *ex ante* but also *ex post*. An agreement following the occurrence of a particular risk not to rely on Art. 437 is no more, he says, than a provision concerning

[38] The general approach to classifying rules of Portuguese law relied on by BST was not in the court's view helpful given the particular context.

the occurrence of a known risk. His contention is that as a rule grounded in good faith, the application of Art. 437 can never be totally excluded. For this reason, in his opinion it is to be regarded as mandatory.

498. In his evidence, Professor Câmara accepted the importance of good faith in Portuguese law. However, he points to the importance of other considerations, in particular the importance attributed to party autonomy, and emphasises that the good faith principle appears in different statutory contexts, and that it plays a limited function within Art. 437. He identifies six "indicators" which in his opinion show that Art. 437 is non-mandatory. These (and the court's view on each) are as follows:

(1) The parties can fully describe the risks and circumstances that relate to the contract thereby waiving the application of Art. 437. However, Professor da Frada disagreed, and whilst BST criticises his oral evidence in this regard, the court's view is that this "indicator" puts in a different way the question for decision—Art. 437 excludes "risks covered by the contract", and the parties can describe the risks, but the question is whether they can "fully" describe risks which are not foreseeable, or whether Professor da Frada is correct to say that because risks may not be foreseeable, they cannot exclude Art. 437 entirely.

(2) It is common ground that Art. 437 does not apply automatically but must be raised by one or other party—in other words, it is not a point which a court would take of its own motion (*ex officio* as it was put). It was contrasted in the evidence with Art. 334 of the Civil Code which deals with "abuse of right". Neither party was entirely consistent in its treatment of Art. 334. BST at the outset of the trial relied on the article in its substantive case, but did not pursue this contention in closing submissions. In his supporting evidence, however, Professor Câmara had asserted that Art. 334 was mandatory. At the outset of the trial, the Transport Companies' position in this regard was that Art. 334 had to be raised by the injured party, hence the fact that Art. 437 had to be raised by a party was of no significance. But Professor da Frada did not maintain that position in evidence—it is now common ground that Art. 334 can be raised *ex officio* by the court. The Transport Companies say that this is ultimately a procedural matter which does not settle the question whether Art. 437 can be derogated from by contract. It does not settle it, but the court agrees with BST that it is nonetheless significant, and tends to support BST's case.

(3) Professor Câmara places reliance on Art. 438 of the Civil Code which provides that, "The injured party does not have a right to terminate or modify the contract if it was in arrears at the time the change in circumstances occurred". This shows, he opines, the subsidiary nature of Art. 437. It is common ground that there are differing decisions of the Supreme Court as to what this provision means. The earlier decision applies doctrine to the effect that Art. 438 only applies where it is the injured party's own delay in performance that has exposed him to the risk of the abnormal change in circumstances, so that it would be improper for him to benefit from the change. The Transport Companies recognise that a differently constituted Supreme Court has more recently taken a different view, but say that the existence of the restrictive view of Art. 438 indicates that it cannot be properly relied on to support the

wider proposition that the application of Art. 437 is subordinate to party autonomy. On balance, the court broadly accepts that submission, considering that Art. 438 is best read as defining or limiting the scope of Art. 437, but it does not cast much light on the mandatory nature of the provision.

(4) The fourth "indicator" is to the effect that the parties can contractually regulate termination and modification, and essentially makes the same point as the first.

(5) Professor Câmara points out that Art. 437 gives rise to remedies of termination or modification, but does not lead to contractual invalidity. However, as Professor da Frada says, the force of this point is countered by Art. 433 of the Civil Code by which termination is equivalent, regarding its effects, to nullity or voidability of the agreement.

(6) Professor Câmara says that Art. 437 is "an exceptional rule to the *pacta sunt servanda* principle that cannot be applied by analogy". His contention is that Art. 437 is a provision which derogates from the general rule of *pacta sunt servanda*, and that such exceptional rules are a "less intense" expression of the Portuguese legal system's values than general rules, and so can more readily be derogated from by the parties by contract. This issue has been noted above. Professor Câmara appeared to accept in cross-examination that he could not identify any authority that supported his view that Art. 437 was an "exception" to the principle of *pacta sunt servanda* (as opposed to a rule in conflict with the principle of party autonomy). The opposing view of Professor da Frada is that *rebus sic stantibus* is "a particular expression of justice, including good faith principles". He said that it is not appropriate to view it as "an exceptional rule", because historically the origins of the doctrine lie in the *pacta sunt servanda* principle itself. Again, on balance, the court accepts his evidence in this regard, and does not accept that *rebus sic stantibus* derogates from *pacta sunt servanda*. As Professor da Frada puts it, the two concepts are "in line", because each parties' will is to be understood in the context of the specific circumstances in which it was exercised.

(vi) The court's conclusion on whether Art. 437 is "mandatory"

499. In the light of this discussion, the court expresses its conclusion as to whether Art. 437 is a rule which cannot be derogated from by contract, in other words a "mandatory rule" within the meaning of Art. 3(3) of the Rome Convention.

500. In closing, BST submitted that it suffices under Art. 3(3) that a rule can be waived by agreement of the parties after circumstances have arisen which allow one or other of the parties to rely upon it (*ex post* waiver). This is material because, it says, in the present case, it is undisputed that Art. 437 can legitimately be subject to *ex post* waiver as a matter of Portuguese law, and it follows that it is non-mandatory.

501. The Transport Companies suggested in closing that this was a new point, not referred to at the opening of the trial.

502. The court does not accept this. The reference to "waiver" may be new, but it has been BST's case from the beginning of the trial that Art. 437 needs to be invoked by a party before it applies, and that if the parties are free not to raise it, the parties can

agree not to raise it, so that by definition, the rule is not one that cannot be derogated from by contract.

503. The Transport Companies submit that an *ex post* agreement not to rely on Art. 437 following the occurrence of a particular risk is an agreement concerning the occurrence of what is by then a specific and known risk, rather than an agreement to exclude Art. 437 altogether.

504. However, such an agreement does have the effect of excluding Art 437 from the time of the agreement, and the rule is therefore derogable at least to that extent.

505. The court further accepts the submission of BST that to "derogate" from a rule does not mean that the rule must be capable of being "ousted" altogether.

506. It is sufficient to take a rule out of Art. 3(3) of the Rome Convention, in the court's judgment, if the rule can be disapplied by agreement between the parties whether *ex ante* or *ex post*. To take the present case, this distinguishes Art. 437 of the Civil Code, which deals with change of circumstances, from Art. 1245, which invalidates gaming and betting contracts. BST accepts that this is mandatory. Plainly, parties cannot contract out of rules applicable to gaming and betting contracts in any circumstances.

507. This conclusion seems consonant with commercial sense. All modern legal systems have to provide for the situation in which following the parties' agreement, there has been a fundamental change of circumstances. Depending on the precise provision, outcomes may be different, but at least in the context of financial contracts like swaps, there seems no reason why the issue should not be referred to the law chosen by the parties.

508. For these reasons, BST succeeds on this issue.

(vii) What the position would be if this conclusion is wrong

509. If this conclusion is wrong, and the ability to contract out of the provision after circumstances have arisen which allow one or other of the parties to rely upon it does not suffice to take it outside Art. 3(3) of the Rome Convention, what is the position then?

510. The issue is a narrow one. The Transport Companies' submission in substance is that Art. 437 is to be treated as mandatory within the meaning of Art. 3(3) of the Rome Convention because before it becomes engaged, the parties are not able to contract out of the rule entirely.

511. As a matter of background, the experts agree that "abnormal change" is often referred to in Portuguese doctrine and jurisprudence as change which is "unpredictable". The Transport Companies say that, as a matter of logic, if a change cannot be foreseen or predicted, the parties cannot make provision for it in the contract. This is relevant, because it is a condition for the operation of Art. 437 that "the abnormal changes do not form part of the risks covered by the contract".

512. The principal difference between the experts in this regard is identified in their joint memorandum.

    (1) Professor da Frada is of the opinion that Art. 437 cannot be derogated from by a private agreement between the parties because it constitutes an expression of objective justice.

    (2) Professor Câmara on the other hand considers that it is not mandatory (the key points being those identified above), and that the parties can disapply it by agreement.

513. Professor Câmara accepted that he had not come across a contractual provision that specifically excluded Art. 437.

514. Professor Câmara also expressed the view that the parties can disapply Art. 437 by choosing a governing law that does not include an equivalent rule. This accords with the court's view of the commercial sense of the situation. But it was not greatly explored in the Portuguese law evidence or submissions. Professor da Frada must clearly be taken to be of the opposite view.

515. The court does not accept BST's submission that there is a "heavy preponderance" of commentary directly suggesting that Art. 437 is non-mandatory.

516. In particular, Professor Câmara himself accepted that the importance of the role of good faith in Art. 437 is not a matter on which there is consensus.

517. The court finds that there is no consensus as to whether the role of good faith is a limited one within the terms of Art. 437, as he maintains, or whether it has a residual role which cannot in any circumstances be wholly contracted out of, as Professor da Frada maintains:

    (1) There is no decision of the Portuguese courts which is directly in point.

    (2) Of the six factors identified by Professor Câmara, the only one with real weight was that Art. 437 must be raised by the parties, and is not something which the court would raise of its own motion.

    (3) However in the court's view whilst significant this is not decisive.

518. Ultimately, the court has to choose between two expert opinions. Although at one point BST asserted Professor da Frada's "serious loss of objectivity", rightly neither side made any serious attack on the quality of the other party's experts.

519. The Transport Companies point out that Professor Câmara has spent most of his professional career as a regulatory lawyer first with the Portuguese Securities Commission and thereafter in private practice in this specialist area of law. He is an expert in financial regulatory law, but he does not have the same expertise in private law, and in particular in the *rebus sic stantibus* doctrine of Art. 437 of the Civil Code. By contrast, Professor da Frada is pre-eminent in Portugal in this area of private law.

520. Though Professor Câmara is interested in the relationship between financial law and civil law, the court considers that there is force in this point. The particular appraisal

that is at issue depends on rooting *rebus sic stantibus* within the whole of the law of contract.

521. Good witness though Professor Câmara was, Professor da Frada was better qualified in that respect. His views are cited by the Supreme Court in its decision of 10 October 2013 referred to above (and below) which involved a swap. The writings of Professor de Almeida Costa provide a counterweight, but as Professor Cordeiro put it, "We have accepted the derogable nature on principle of the doctrine of change of circumstances; however, even here, the *nihil obstat* of good faith always prevails".

522. On balance, the court accepts Professor da Frada's evidence that as a matter of Portuguese law the application of Art. 437 of the Civil Code can never be totally excluded on an *ex ante* basis.

523. If, contrary to the court's opinion expressed above, this has the result that Art. 437 is a provision which cannot be derogated from by contract within the meaning of Art. 3(3) of the Rome Convention, the Transport Companies would succeed on this issue.

(2) The Portuguese case law

524. The finding on the first issue means that the substantive issues as to the meaning and application of Art. 437 do not arise. However, since they were argued in full at trial, the court will express its conclusion. Each is important, and each is in dispute.

(i) The decisions

525. It is convenient first to consider the evidence as to the Portuguese cases that deal with interest rate swaps and the application of Art. 437. This is potentially relevant to each of the substantive issues.

526. There is some difference between the experts as to what is meant by "abnormal change". Professor Da Frada says that there is no requirement that the change has to be "extraordinary": it is enough that the change is "objectively out of the usual and a-typical".

527. In the light of the view taken by the court on the facts, it is unnecessary to resolve this. The court is content to proceed on the basis that Professor Câmara is correct to say that only an unpredictable and extraordinary change that gravely affects the performance of at least one of the parties may justify the application of Art. 437. The formulation that sometimes appears in the Transport Companies' submissions as to "great" change of circumstances is consistent with this.

528. The experts disagree as to the effect of the jurisprudence regarding the application of Art. 437 to swaps. In their statements in the joint memorandum, Professor da Frada considers that the Portuguese courts have consistently acknowledged the relevance of the financial crisis as regards swaps, deeming Art. 437 as applicable to such agreements. Professor Câmara considers that Portuguese court decisions have so far come to disparate conclusions.

529. Three of these decisions have been referred to above: the Supreme Court judgment of 10 October 2013 (1387/11.5TBBCLG.G1.S1), the Lisbon Court of Appeal judgment

of 15 January 2015 (876/12.9TVLSB.L1-6)[39], and the Lisbon Court of Appeal judgment of 28 April 2015 (540/11.6TVLSB.L2-1). A further decision is that of the Lisbon Court of Appeal decision of 8 May 2014 (531/11.7TVLSB.L1). A more recent decision is that of the Lisbon Court of Appeal of 2 July 2015 (2118-10.2TVLSB.L1.-2).

530. The discussion between the experts mainly concerned what can be derived from these decisions so far as the present case is concerned.

531. It is important to note that:

(1) None of the decisions concerned the "snowball" type swaps at issue in this case in which the effect of low interest rates is both accumulated and leveraged, resulting, as explained below, in payments calculated by reference to rates which are far higher than any considered by the Portuguese courts or academic commentators to date. That caveat must be borne in mind throughout the following discussion.

(2) In the course of their decisions, the Portuguese courts discuss the meaning of "abnormal change in circumstances" in the context of the other questions that arise under Art. 437, that is, upon what basis the parties decided to enter into the swaps, whether the change forms part of the risks covered by the contract and whether requiring fulfilment of a party's contractual obligations would be a serious breach of the principles of good faith—as one would expect, the questions run together.

532. The most significant decision discussed by the experts is the Supreme Court decision of 10 October 2013. Professor da Frada's earlier writings were cited by the Court, which said:

> "As Carneiro da Frada warns, with regard to whether the current financial crisis represents a major change of circumstances, "the unexpected and profound manner with which the current crisis erupted, to the surprise of many or almost all, even experts, it seems to point in that direction. Among the factors to be considered the following must be considered, the scope of its reach, the fact that it could not be anticipated and the fact of it being rooted in multiple interdependent causes that are beyond the control and influence of individual economic stakeholders (however important they might be) so that they can protect themselves, as a global crisis, beyond the boundaries of countries and various economic areas of the planet) (see page 682 of the cited work)."

533. In the result, the Supreme Court upheld the decisions of the lower courts applying Art. 437 to swaps in the context of the financial crisis, regarding it as being an abnormal change of the circumstances upon which a five-year interest rate swap had been contracted.

[39] Upheld by the Supreme Court in its decision of 26 January 2016.

534. As BST points out, the court treated the counterparty as unsophisticated in that case, and this played a part in the decision.

535. It was criticised by Professor Câmara along with the Lisbon Court of Appeal decision of 8 May 2014 on the basis that the Courts had not made a proper assessment of the risks covered by the contract. However that criticism was not convincing, and the court rejects it.

536. But as he says, that decision can be contrasted with other decisions (including several first instance decisions).

537. In the three Lisbon Court of Appeal decisions of 2015, being the most recent upon which the experts commented, the outcomes varied.

538. In the decision of 15 January 2015, the Court considered that the lowering of interest rates was not sufficiently serious to invoke Art. 437. The court said that "…the downward variation that was seen in the rate that was no more than 4%, leads us to conclude that the change that was neither subjectively nor objectively involves the seriousness, unpredictability and especially onerousness that justifies recourse to the special/exceptional termination of the agreement due to abnormal change of circumstances".

539. In the decision of 28 April 2015, on the other hand, the Court treated the economic crisis as a change in the circumstances on which a 5-year swap had been contracted.

540. BST seeks to distinguish this decision on the facts, commenting that the swap was considered to have been "grievously mis-sold" as protection against an increase in EURIBOR.

541. But in rejecting the bank's contention that the fall in 3M EURIBOR rates was envisaged by the contract was normal and an inherent risk of the contract, the Court identified the prolonged nature of the situation, saying:

> "… in the face of the (lack of) information provided by the bank to R, the contingency factor of the contract envisaged the occasional case of a fall in the 3-month EURIBOR rate below 4.05% as result of normal market oscillations, in which case R. would have to pay 4.72%. But in no way did it envisage a situation of prolonged and significant reduction of this rate as a result of a persistent international crisis as occurred in 2008/2009. This was an abnormal alteration of circumstances seriously affecting the obligations undertaken by R. according to the principles of good faith. All the more so because the lack of information already mentioned makes the abnormality of this alteration in circumstances more apparent. Thus there are legal grounds for the termination of the contract under the terms of art. 437.1 of the CC, therefore this part of the ruling appealed against is to be confirmed".

542. The last of the three Lisbon Court of Appeal decisions, that of 2 July 2015, also concerned a plain vanilla swap (page 8). Having cited extensively from academic

commentary, the Court held that the "sharp fall" in interest rates was within the risks covered by the contract:

(1) Based on the summary prepared by the rapporteur at the beginning of the decision, Professor Câmara accepted that this decision ultimately turned on the facts, though as he pointed out, the summary also says that, "It is hard to admit that the sharp decline of interest rates was not covered by the risks of interest rate swap contracts".

(2) The Court stated that to succeed, the claimant would have had to allege and prove that "that the basis of the swap contract had been that the EURIBOR would not fall below the minimum limit agreed therein, and that a certain market situation would be maintained as far as the interest is concerned".

(3) A footnote refers to the writings of Professor Paulo Mota Pinto, to the effect that it would be necessary "to demonstrate specifically, in the light of the contract that was entered into, that one of the circumstances on which the parties based (albeit implicitly, presupposing it without asserting or representing it) their joint decision to contract was indeed the non-occurrence of a crisis with such consequences".

543. The decision of the Lisbon Court of Appeal of 15 January 2015 was upheld by the majority of the Supreme Court on 26 January 2016. It was stated (in the translation agreed by the parties):

> "As for irresistibility, we would have to take a trip from the Letter of Washington, by the commemorated Bill Clinton or from the policy of totally loose capitals unleashed in 1997, to the first Margaret Thatcher government introducing total market deregulation principles in order to explain why the regulators have failed and the lethargy of supervising authorities (?) of banking entities in order to offer an exact and full explanation on the unpredictability of the crisis. It would be inappropriate for a judicial decision to go through an assessment of all the reasons, but a brief look (even if superficial) to the works referred to in note 8[40] may provide capable and valid elements to lodge the idea that crises are inherent to capitalist systems and that only extreme situations such war or a disaster induced by natural uncontrollable factors (human or Act of God) may grant the character of externality to crises of the system."

(ii) The court's consideration of the cases

544. The court considers that overall these decisions result in a restrictive view of the effect of the financial crisis on interest rate swaps.

545. As BST says, movements in interest rates are not in and of themselves abnormal changes of circumstances.

[40] Which refers to a number of writings on the crisis.

546. Equally, however, it has been held that, if prolonged and significant as a result of the crisis, movements in interest rates can be abnormal changes of circumstances.

547. BST also says, and this is consistent with the terms of the decision of 28 April 2015, that interest rate changes can only be abnormal changes of the circumstances under which parties enter into a contract if the basis of the contract was that the rates would not behave as they have done.

548. However, BST's further submission that, in the present case, this would mean the Transport Companies proving that the swaps were entered into on the basis that the relevant reference rates could never fall (and stay) below the relevant barriers, is an unjustified gloss which the court does not accept.

549. Insofar as either side submitted that there was a "trend" in the cases either in favour of enforcing or not enforcing interest rate swaps post-crisis, the court does not consider that the evidence justifies such a finding.

550. On the evidence it has received, the court finds that these decisions are fact-sensitive.

(1) The swap that was enforced in the decisions of 15 January 2015 / 26 January 2016 concerned a 5 year swap with a notional of €2m. The bank paid the variable rate of 3M EURIBOR. The company paid (a) a fixed rate of 4.66% if 3M EURIBOR was either less than 4.15% or fell within the band 4.66% to 5.3%, (b) otherwise 3M EURIBOR. The company estimated its losses under the agreement to be €218,042.02, rising to €320,000 if the swap ran to term.

(2) The swap that was enforced in the decision of 2 July 2015 was for a 5-year term and provided that, when interest rates fell below 5.35%, the customer would pay a fixed rate of 4.53%.

(3) Doubtless these swaps turned out to be bad bargains, but the facts are clearly very different from the present case.

551. BST says that the Supreme Court decision of 26 January 2016 supports its submission that there is no basis to regard the interest rates movements following the 2008 financial crisis as an abnormal change of a relevant circumstance for the purposes of the swaps in these proceedings.

552. The Transport Companies contest this.

553. The court's view is that:

(1) The decision is one of a number, and has to be seen as such.

(2) On the case law available at trial, Professor Câmara considered that Portuguese court decisions had so far come to disparate conclusions.

(3) Consistently with this, the decision of 26 January 2016 is itself a majority decision.

(4) The relevant swap was contracted in June 2008 when the crisis was well underway. The majority's findings as to predictability are to be seen in that light.

(5) The dissenting judge considered that the fact there were already signs of instability at that time does not mean the scale of the crisis and its global impact was predictable.

(6) Whilst the majority stated that volatility in interest rates cannot be regarded as a valid element in the assessment of change of circumstances, the present case concerns the effect of interest rates remaining at or near their "zero lower bound" since 2009.

(7) The structure of the swap was completely different to the swaps in the present case, and there was no "snowball".

(8) Whether or not circumstances are abnormal is a matter of fact.

(9) The Supreme Court reached its findings on the basis of the writings which it identifies.

(10) This court has received evidence from economists which is set out below.

(11) This court is bound to, and has, reached its own factual conclusions on the evidence before it.

(12) Therefore whilst it is right to say that the decision is supportive of BST's case, it does not change the overall analysis.

(3) The circumstances on the basis of which the parties entered the swaps

554. The first substantive issue is as to the circumstances on the basis of which the parties based their decision to enter into the swaps—see the language of the article set out above. This is a factual matter.

555. The seven swaps relevant to this part of the case were entered into between 6 June 2005 and 2 November 2007.

(i) The parties' cases

556. The Transport Companies' case is that the basis on which the parties contracted in broad terms was that existing macro-economic conditions would continue i.e. there would be no prolonged major shock to the economic system, such as has occurred as a result of the Global Financial Crisis ("GFC"), affecting interest rate levels.

557. Their case is that the parties did not anticipate the effect of the GFC, which was to reduce interest rates to zero or near zero levels for a prolonged period of time in, they submit, a completely unprecedented manner.

558. In closing submissions, BST reiterated a submission made in oral openings, to the effect that the Transport Companies should be held to their pleaded case in this regard.

559. BST submitted that this limited the Transport Companies' case as to relevant circumstances to (i) an historical analysis of interest rates, including the fact that 6-month EURIBOR rate had dropped below 2% on only one occasion prior to the crisis, (ii) that market consensus was that reference interest rates would continue to rise in 2007, and (iii) that as at the time of concluding the relevant swap, forward rates for 6-month EURIBOR rate until October 2017 were between 3.5% and 4.25%.

560. As at the time the swaps were concluded, BST pointed out, these points were factually correct.

561. On that basis, BST submitted that the pleaded circumstances on the basis of which the parties based their decision to enter into the swaps were historical facts which never underwent any change. It is said that there is no plea that only normal economic activity was anticipated by either party to be encountered throughout the swaps' respective terms, and though there is a plea that the Transport Companies considered that it was highly unlikely that rates would evolve in a manner as would expose them to substantial losses, this was again not a circumstance which underwent any change.

562. The court agrees with BST that a case based on market consensus that reference interest rates would continue to rise, or that rates would not change so as to expose the Transport Companies to substantial losses, would be unsustainable. It could not be credibly argued that the parties based their decision to enter into the swaps on such a consensus, which in any event could be no more than an opinion or forecast. As BST says, this was factually the consensus at the time.

563. However, that is not the Transport Companies' case. They rely on these matters as evidence that the parties contracted on the basis that past macro-economic conditions would continue in the future.

564. The court accepts their submission that taking the pleadings as a whole, their case as to the continuance of macro-economic conditions is sufficiently pleaded in substance. The precise words "macro-economic" are not used in the pleadings, but there is reference to the "economic climate" and "normal economic activity", and reliance is placed on the abnormal position as regards interest rates since the second quarter of 2009 following the financial crisis.

565. Further, their case is addressed by the experts in their reports, was the subject of evidence and submission at trial, and was met by a detailed rebuttal in BST's written closing submissions. It is not in the court's view credible to say that the Transport Companies could not run it.

(ii) The parties' expectations

566. The Transport Companies submit that the contemporary material shows that the events of the GFC and its impact on interest rates did not form part of the expectations and therefore part of the basis on which the parties contracted the swaps.

567. The court accepts this. The fact that the parties never expected a long period of near zero interest rates was confirmed in the oral evidence at trial as the evidence of Ms Antunes for BST shows:

"Q. … Would I be correct in saying that even on a worst case scenario the bank never expected, when it entered into the swap, that the lower barriers of the first MdL swap would be breached for such a sustained period of time.

A. That's correct."

568. The Transport Companies' witnesses expressed similar views. As Mr Pinto of MdP put it, the expectation at the time of contracting the first MdP Swap was that "rates below 2% was possible, and it was expectable in scenarios of great retraction … but it was not our expectation that it could go for a long period of time".

569. As the Transport Companies say, this is not surprising. The contemporary material including by way of technical analysis shows expectations as to interest rates on the part of the parties which were conventional at the time. This includes the last trade date, which was 2 November 2007 (the STCP swap).

570. It is correct to state, as BST points out, that even under "normal" conditions, these expectations might turn out to be completely wrong. But the parties could not foresee the drastic changes to macro-economic conditions caused by the Global Financial Crisis, or the effect that this would have on interest rates as described below.

571. As a matter of fact, the court finds that the circumstances on the basis of which the parties based their decision to enter into these swaps, being "snowball" swaps in respect of which once interest rates fell below the lower barrier the amount payable rose on a leveraged and cumulative basis, was that existing macro-economic conditions would continue to the extent that neither party envisaged that interest rates would fall to near zero for a prolonged period—which as explained below, is unprecedented. This possibility was not foreseen even as very unlikely. The court accepts the Transport Companies' case in relation to this issue.

(4) Whether there has been an abnormal change in circumstances

572. It is of the essence of this provision that circumstances have changed abnormally. This hinges on the effect of the Global Financial Crisis (GFC) and its aftermath on interest rates in the context of these particular swaps.

(i) Portuguese law

573. The law in this respect is set out above.

(ii) The facts—the effect of the Global Financial Crisis

(a) The parties' cases

574. The Transport Companies' case is that:

(1) The Global Financial Crisis and the resulting prolonged period of near zero interest rates from the second quarter of 2009 is a major change in circumstances which falls within the scope of Art. 437 of the Civil Code.

(2) Monetary policy which formed the background to the swaps as entered into between June 2005 and November 2007 was that existing macro-economic circumstances would continue, and that this would not involve a financial crisis in which there would be a sustained fall in interest rates to record low levels.

(3) The crisis forced central banks to lower interest rates to near zero, and adopt non-standard measures such as quantitative easing.

(4) Non-conventional policies included interest rates at exceptionally low rates being held for unusually long periods of time.

(5) The scale and nature of the GFC, the failure of mainstream economic thinking to anticipate or accommodate the crisis, the unconventional monetary policies that were required, and particularly the low rate of nominal interest rates for an abnormally long time, amount to an "abnormal change of circumstances".

575. BST's case is that:

(1) Real (as opposed to nominal) interest rates have not been unusually low, and crises or unusual policies are not "abnormal".

(2) The effect of the GFC on interest rates was not abnormal, and in fact interest rates have not been unusually low for an unusual period of time.

(3) Following the crisis, events occurred in a manner which was in part unforeseeable, but in part reflective of known macro-economic conditions. Low interest rates for a substantial period of time were a predictable outcome of the banking crisis, as in other such crises, and were consistent with "existing macro-economic conditions".

(4) In the light of the macro-economic conditions existing in 2005-2007, including known uncertainties, what happened in 2008 and following was not outside the landscape of normal economic activity.

(5) Accordingly, the Transport Companies' case of "abnormal change" in "existing macro-economic conditions" has not been established.

(b) Changes in the benchmarks are irrelevant

576. At one point, the Transport Companies also appeared to contend that the relevant reference rates themselves, that is EURIBOR and USD LIBOR, were a "very different phenomenon" in the post-financial crisis world. This point does not appear to have been pursued, and it would have been rejected by the court if it had been. Such changes as there have been in these benchmarks are legally irrelevant. The rates continue to be similarly constructed, seek to reflect the wholesale cost of financing for banks, and to move closely with the rates set by central banks. The nature of EURIBOR and USD LIBOR has not changed since the financial crisis.

(c) The expert evidence

577. The expert evidence on this subject was given by economists, Professor Charles Wyplosz for BST, and Professor Giancarlo Corsetti for the Transport Companies. Both are respected international commentators on the financial scene. On the face of their reports, there was a considerable difference of opinion between them, but much of this evaporated in the course of the evidence.

(d) The onset and development of the global financial crisis (GFC)

578. For convenience, Professors Corsetti and Wyplosz break down the analysis of the GFC thus far under three phases: from August 2007 to September 2008, from September 2008 onwards, and the sovereign debt crisis.

579. In summary, for present purposes, the crisis can be taken to have begun on 9 August 2007, when BNP Paribas terminated withdrawals from three hedge funds on the basis of "a complete evaporation of liquidity"[41]. Reflecting this, the first phase of the crisis is generally known as the "credit crunch".

580. At that time interest rates did not diverge radically from a "conventional" pattern. EURIBOR had been raised in August 2008, and was around 5% by Autumn 2008. The Fed Funds Target rate was at 2% in September 2008, rates having been progressively lowered—in June 2008, a decision was taken not to lower them further as "financial market conditions generally appear to have improved modestly".

581. In fact, financial market conditions did not improve, and the next phase of the crisis began with a cluster of well-known events in September 2008. In particular, on 15 September 2008, Lehman Brothers filed for bankruptcy, and on 16 September 2008, AIG[42] required emergency assistance to prevent it also failing.

582. Interest rates swiftly and sharply reduced, EURIBOR falling from 5% to around 0.5% in six months. The Fed Funds Target rate which had been at 2% fell to within a range of 0-0.25% by the end of 2008, closely tracked by LIBOR.

583. The next phase of the crisis concerned sovereign debt, and arose (so far as relevant) in the euro area. There is disagreement between the experts as to the time of commencement of this phase: Professor Corsetti places it in 2011, and Professor Wyplosz places it in 2010, but the difference is immaterial.

584. By 2011 there was a crisis, and EURIBOR rose to just over 1% for a time in 2011—the experts agree that this was in response to a "policy mistake" by the ECB. The rates fell back to near zero in 2012. The significant point is that the experts agree that since February 2009, 3 month EURIBOR rates have been at a low level which was unprecedented since EURIBOR was established in December 1998 (on the introduction of the euro on 1 January 1999).

585. US dollar interest rates have remained at near zero from the end of 2008. After the hearing ended, the fact that the Federal Reserve decided on 16 December 2015 to

[41] Earlier dates can be adopted: in June 2007, Bear Stearns stopped redemptions in two of its hedge funds.
[42] American International Group was at the time the world's biggest insurer.

raise the target range for the federal funds rate to 0.25 to 0.5 percent was very widely publicised.

586. Economists refer to the situation in which policy interest rates set by a central bank are at or near zero as the "zero lower bound" (ZLB), or the zero lower bound problem. The theory is (or was) that interest rates cannot readily be set at lower than zero, since there is no incentive to place money at a negative rate, thereby placing a constraint on monetary policy. Negative interest rates slightly below zero have in fact been introduced by the ECB and some other central banks on bank reserves, the evidence being that this is a direct response to the conditions created by the crisis.

(e) The parties' contentions: discussion and conclusions

587. BST points to the fact that it is common ground between the experts that "real interest rates have not been unusually low". But this is the result of the relationship between "real" interest rates and inflation, and inflation has also been near zero. The court agrees with the Transport Companies that it is not relevant to the issues for decision, which concern the effect of low nominal interest rates on the contracts in question.

588. BST's case is that banking crises tend to be more prolonged than pure stock market crashes, and typically endure for four to six years. The usual response of central banks is to adapt their monetary policy and bring interest rates low and to hold them for as long as is necessary, as is common ground. It submits that low nominal interest rates, constrained by the ZLB, for periods in excess of four to six years, were a predictable outcome of a banking crisis, and are consistent with the "existing macro-economic conditions" when the swaps were entered into. It relies on the following main points.

589. BST says that when talking about monetary policies, interest rates, or the economy more generally, there are times which may be described as 'normal', but that times of crises or unusual policies or rates are not 'abnormal'. Professor Wyplosz described the GFC as a classic financial crisis. He added that there is no concept of "abnormality" in economics.

590. However, as the Transport Companies submit, the fact that in the abstract crises occur, and are in that sense normal, does not inform one about this crisis. It is correct that there have been a number of crises in recent times—BST cites the 1970s energy crisis, the early 1980s recession, the 1987 stock market crash ('Black Monday'), the Swedish banking crisis and other Scandinavian crises of the 1980s and 1990s, the Asian crisis of the late 1990s, affecting Thailand, South Korea and others, the 1998 Russian crisis and rescue of LTCM; and the bursting of the dot.com bubble in the early 2000s. Others might be added.

591. But the court accepts the evidence of Professor Corsetti that these bear no comparison with the Global Financial Crisis that came to a head in September 2008 as described above. Nor is there any real comparison with the position in Japan so far as this analogy was pursued.

592. By the end of the evidence, this was not really in dispute. The only true comparator of the GFC is the stock market crash of 1929 and the ensuing Great Depression, and

even that may not be fully apposite. As Ben Bernanke, Chairman of the US Federal Reserve from 2006 to 2014, has put it:

> "In public I described what was happening as the "worst financial crisis since the Great Depression" but privately I thought that – given the number of major financial institutions that had failed or come close to failure, its broad-based effect on financial and credit markets, and its global scope – it was almost certainly the worst in human history. Whether the financial crisis would touch the deepest economic downturn since the Depression, or something worse, remained an open question." (*The Courage to Act*, W.W. Norton & Company, 2015)

593. Professor Wyplosz did not demur from this description, accepting Mr Bernanke's status as an economic historian. It is consistent with his own writing prior to the trial. In an October 2011 note, he referred to the financial crisis being of "historical proportions, fully remindful of the 1929 crisis".

594. Whether or not there is a concept of "abnormality" in economics appears a largely semantic objection, and arises because "abnormal circumstances" is the term used in the applicable provision of the Portuguese Civil Code. In fact, the evidence is that references to normality are frequent in the literature, including by Professor Wyplosz himself, and other distinguished economists. There is in any case no difficulty in applying the term to a factual situation like this.

595. The crucial issue is how the effect of the crisis on interest rates is to be regarded, because as magnified by leverage and accumulated by the "snowball" structure, this is what has produced the very high interest rates in the case of these particular swaps. In this regard, BST makes a number of points.

596. As BST says, Professor Corsetti did not maintain his initial position that rates could be defined as unusually low if held at near zero for a period in excess of six quarters. This however was only put forward as an attempt at an objective test, and does not affect the thrust of his evidence.

597. The court does not accept BST's suggestion that the effect of the raising of EURIBOR in 2011 means that there would in any event be no possibility for the Transport Companies to establish six consecutive quarters of reference rates at the ZLB—the experts agreed that the temporary rise to just over 1% was in response to what they called a "policy mistake" by the ECB, and one which was soon reversed. The court finds that the temporary rise in 2011 in the context of the sovereign debt phase of the crisis does not affect the overall picture.

598. Professor Wyplosz's evidence, which in this respect is common ground, is that the response of central banks to banking crises is to adapt their monetary policies typically involving (i) quickly and sharply cutting the policy interest rate, (ii) promptly injecting a large amount of liquidity into the interbank market and (iii) providing emergency support to ailing commercial banks.

599. The question to be answered however is as to the response in relation to the GFC. All these things were done, but it is common ground that the scale of the crisis as it erupted in September 2008 required a response that went well beyond this.

600. There were two main elements that were explored in the evidence, the first being quantitative easing. This is the process by which certain central banks have created money to buy financial assets on a large scale in response to crisis conditions. In a commentary in September 2013, Professor Wyplosz described the Federal Reserve's quantitative easing programme as "having no historical precedent". This applies equally to the quantitative easing programmes adopted by the ECB and the Bank of England.

601. As regards interest rates, which are the second element, the factual position is described above. BST is correct to point out that there have been other instances where low interest rates have prevailed for extended periods. The evidence identified US interest rates during the Great Depression and the Second World War (there was disagreement between the experts as to the appropriate rate which the court need not resolve), and contemporary interest rates in Japan.

602. However, the court accepts Professor Corsetti's evidence that the situation resulting from the Global Financial Crisis is very different even from these. In fact, among the vast amount of material before the court on this issue[43], the point emerges sufficiently from a paper[44] prepared by Professor Wyplosz for the European Parliament in February 2013. He refers to "the down phase of the cycle" as being "extraordinarily long", saying that "interest rates may eventually revert to normal levels", but because of "the depth of the crisis" especially in the euro area "this might take quite some time".

603. He pointed out in the paper that the ECB's policy rate had been almost at the zero lower bound for about four years, and predicted that "we may experience a few more years of near-zero rate". In fact, at the time of this judgment, they are still at this level.

604. As a result, Professor Wyplosz said, "we seem to live in a different world".

605. Of the three central banks whose policy interest rates featured most in the evidence, the Bank of England has the longest experience. Since March 2009, the Bank of England base rate has been 0.5%. Statistics produced by Professor Corsetti go back to 1824, and show that prior to March 2009, the base rate had never fallen below 2%. Professor Wyplosz points out that the effect of going off the gold standard in 1931 was to devalue the currency obviating, he says, the need to further lower interest rates—but this does not detract from the fact that current interest rates are unprecedented.

606. The issue then arises between the parties as to the extent to which this state of affairs was predictable.

607. It is agreed that it was not in fact predicted, and that even figures who expressed concerns prior to the crisis did not predict its precise modalities. Though concerns as

[43] The combined appendices to the reports of Professors Corsetti and Wyplosz took up 17 files.
[44] *The Challenges of a Low Interest Rate.*

to the financial system were expressed, the professors agree that they were dismissed by leading policymakers and academics based on arguments (i) that international diversification of assets would prevent a large shock from translating into a global systemic shock, and (ii) that the "Greenspan experience" in terms of an aggressive policy response to severe financial shocks, together with the policy lessons learned from previous crises, offered the necessary guidance for stabilising the economy and the financial system.

608. It is common ground that this turned out to be wrong.

609. Nevertheless, BST argues that the current interest rate environment was predictable in the sense that the period of time for which nominal rates would have to be held at or near the zero lower bound was a 'known unknown' when the swaps were concluded, because with low inflation rates in the years preceding the crisis, and a desire to bring real rates low, central banks would be more likely to bring nominal rates down to their ZLB. Whilst there was uncertainty in this respect, commentators[45] appreciated that at the ZLB non-standard monetary policies might have to be adopted.

610. However, it is clear on the evidence that what happened as a result of the crisis went far beyond this.

611. In an analysis by the President of the Federal Reserve Bank of San Francisco, the ZLB was described as going from a theoretical problem, to a very real problem[46]. The Transport Companies rely on this analysis, and in particular as to what forecasts showed. In that regard "a wide range of macroeconomic forecasting models constructed based on postwar U.S. data predict that the probability of multiple years stuck at the ZLB, is extremely remote—essentially nonexistent".

612. But this is what has happened, and as this passage highlights, it is not just the fact of, but also the longevity of, interest rates "stuck at the ZLB" that has had such a dramatic effect on the "snowball" swaps in this case.

613. An explanation for this failure to foresee or predict what happened is to be found in academic commentary[47] cited by the Transport Companies:

> "The global financial crisis of 2008 was fundamentally a credit crisis on a massive, international scale". Nothing remotely like it had been seen since the 1930s".
>
> "… we did not think something like this could happen. This mistaken belief had two flawed ingredients. First, we saw the chances of a financial crisis as almost impossibly remote – we thought these events happened to others, like emerging markets, but not to us. Second, even if we did admit some tiny risk of crises, we thought they would not be too painful: We

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[45] Including Mr Bernanke: see *Monetary Policy Alternatives at the Zero Bound: An Empirical Assessment*, Bernanke, Reinhart, and Sack, 2004.

[46] John C Williams, President of the Federal Reserve Bank of San Francisco, *Monetary Policy at the Zero Lower Bound*, 2014.

[47] Alan M. Taylor, University of California, *Credit, Financial Stability, and the Macroeconomy*, 2015, summarising the thesis in Martin Wolf, *The Shifts and the Shocks*, 2014.

> could cope and clean up satisfactorily using the policy tools and skills at hand. All seemed well, and faith rested on the Great Moderation[48], inflation targeting, financial development, efficient markets, and a slew of institutional reforms."

614. Drawing the material together, the court broadly accepts Professor Corsetti's evidence to the limited extent that there is still any difference with that of Professor Wyplosz.

615. Professor Wyplosz accepted that the combination of zero interest rates and massive increases in the balance sheets of central banks caused by quantitative easing was unprecedented, and the court finds that each of these factors was unprecedented.

616. The court rejects BST's submission that in light of the macro-economic conditions existing in 2005, including the known uncertainties, what happened in 2008 and following was "not outside the landscape of normal economic activity". As Professor Wyplosz put it in his writing, "we seem to live in a different world".

617. That being so, the court accepts the Transport Companies' submission that, in the case of these swaps, in which the effect of interest rates behaving in an unprecedented manner has been magnified by the snowball structure, there has been a profound change in the macro-economic circumstances on which the parties based their decision to enter the swaps. Applying the test in Art. 437 of the Civil Code, the court accepts their submission that the global financial crisis constitutes an "abnormal change of circumstances" occurring since the parties entered into the swaps in the period 2005-2007; and that the fact that since 2009 policy and swap reference rates have been at unusually low levels for an abnormal length of time, by itself amounts to an abnormal change of circumstances.

618. That finding is consistent with those Portuguese cases which uphold swaps notwithstanding the crisis, because none of them involved snowball swaps.

(5) Whether, if there has been an abnormal change, that change forms part of the risks covered by the contract

619. The next issue is whether, if there has been an abnormal change, that change forms part of the risks covered by the contract.

620. In closing, BST summarised its case on this issue as follows. There are two reasons why, in this case, any abnormal changes in interest rates are part of the risks covered by the swaps. (1) The risks were known to and willingly taken by the Transport Companies; and (2) it was the very purpose of the swaps to respond to movements in interest rates, including those that have been encountered.

621. In closing, the Transport Companies summarised their case on this issue as follows. The essence of a great change of circumstances is that neither contracting party saw it coming, however sophisticated. That is, in substance, what the Transport Companies say about the Global Financial Crisis. Neither the Transport Companies, nor BST, expected interest rates to stay so low for so long with the impact that had on the rates payable under the swaps, so it follows from this that BST cannot have anticipated

[48] A term describing a period of economic stability characterised by low inflation.

itself the possibility of being so disproportionately benefited under the swaps. The result is that it would be unreasonable for BST to rely on a clause that was never designed to cover a macro-economic environment like the present, and why the risk of the particular abnormal change that has happened lies outside the risks covered by the contracts.

622. It is obvious that, and the court accepts that, even under normal conditions, it was foreseeable that interest rates might cross the upper and/or lower barriers for substantial periods of time resulting in elevated interest levels. As BST says, this risk was the *quid pro quo* for the payment stream that the bank paid to the Transport Companies in the early years of the swaps based on the low fixed rate. The risk of elevated interest payments was built into these swaps, and the Transport Companies freely entered into them.

623. However, normal conditions did not prevail. For reasons set out above, the risks that transpired in the Global Financial Crisis of near zero interest rates for a prolonged period (which continues at the time of this judgment) were not known to, and could not have been foreseen, by either party. It is correct that a purpose of the swaps was to respond to movements in interest rates, but not those that have been encountered.

624. BST points to the passage already referred to in the Transport Companies' written closings, in which it is said that it is of the essence of an interest rate swap that it makes provision for every possible change in the relevant reference rate. This, it is submitted, resolves this issue in BST's favour. The court does not accept that, and read with the rest of the Transport Companies' case, the passage in question lies within the macroeconomic framework that obtained at the time.

625. As to the law, reference is made to the discussion above. The test applied by the Portuguese Supreme Court in the decision of 10 October 2013 is whether the risk is "… the tolerable risk; that is to say, the reasonable risk and somehow foreseeable in light of the economic and financial climate at the time the contract was concluded, at the time in which the plaintiff and also the defendant could assess, on an informed basis, if the bank's proposal would meet or not their interests". As explained above, the cases have differed in result depending on the facts.

626. The Transport Companies rely on a comparison between the facts of the present case, and those of the cases considered by the Portuguese courts as set out above. Though it is common ground that the effect of the circumstances on the particular contract is to be taken into account under Art. 437, BST submits that it is not something to be taken into account at the stage of trying to understand what risks have been allocated in the contract. However, as noted earlier, in the course of their decisions, the Portuguese courts discuss the questions that arise under Art. 437 together, as one would expect. The facts are relevant at this stage too.

627. The terms of the swaps in the five most significant cases are not in dispute:

(1) Supreme Court of Justice judgment of 10 October 2013 (1387/11.5TBBCL.G1.S1): 5-year term, providing that when interest rates fell below 5.15%, the customer would pay the fixed rate of 4.55%.

(2) Lisbon Court of Appeal judgment of 8 May 2014 (531/11.7TVLSB.L1): 5-year term, providing that when interest rates fell below 4.15%, the customer would pay a fixed rate of 4.66%.

(3) Lisbon Court of Appeal judgment of 15 January 2015/Supreme Court judgment of 26 January 2016 (876/12.9TVLSB.L1-6): 5-year term, providing that the customer paid (a) a fixed rate of 4.66% if 3M EURIBOR was either less than 4.15% or fell within the band 4.66% to 5.3%, (b) otherwise 3M EURIBOR.

(4) Lisbon Court of Appeal judgment of 28 April 2015 (540/11.6TVLSB.L2-1): when interest rates fell below 4.05%, the customer would pay a fixed rate of 4.72%. Its term is not specified in the judgment.

(5) Lisbon Court of Appeal judgment of 2 July 2015 (2118-10.2TVLSB.L1.-2): 5-year term, providing that, when interest rates fell below 5.35%, the customer would pay a fixed rate of 4.53%.

628. Thus the rates payable by the counterparty in these cases (broadly) ranged from 4.55% to 4.72% over a term of five years. The disparity with floating rates is not comparable to the present case.

629. This is the context of the decision of the Lisbon Court of Appeal of 2 July 2015 cited above that the "sharp fall" in interest rates was within the risks covered by the contract, and so far as it covers this issue (which the Transport Companies dispute) the Supreme Court decision of 26 January 2016.

630. It is the context in which commentators such as Professor Maria Clara Calheiros in *O Contrato do swap no contexto da actual crise financeira global* (2013) cited by BST have written that "it is hard to understand that the sharp drop of the interest rates did not constitute a risk of the contract itself, since it is precisely the possibility that this sharp rise or fall may occur that leads the parties to conclude the swap contract".

631. The Transport Companies are liable to pay interest rates which are far higher than those in the decided cases, as the following table as at 1 October 2015 taken from their submissions (and not disputed), together with the rates payable by BST by comparison, shows:

Swap	BST interest rate liability	Transport Company interest rate liability
Carris 1	0.098%	62.224%
MdL 1	-0.616%	32.1142%
MdL 2	-0.539%	34.3046%
MdL 3	-0.014%	20.905%
MdL 4	-0.014%	71.229%
MdP 1	4.76%	71.864%
STCP	0.176%	36.743%

632. So long as interest reference rates remain outside the barriers—and there is no sign of them moving inside the barriers at the time of this judgment—these rates will continue to rise as a consequence of the "snowball" and leverage factors. Further, the swaps have much longer terms than the five year terms typical of the decided cases.

633. As at 16 March 2015, Mr Harkins expected the interest rate on MdL 3 to rise to 50.61% and the interest rate on MdP 1 to rise to 164.326%. His calculations have not been challenged.

634. The court agrees with the Transport Companies that the risk of this occurring is not a risk covered by the swaps.

635. The 'Risk Evaluation' representation in the Master Agreements (by which the company represented that it was aware "that OTC derivative transactions, like other financial transactions, involve a variety of significant risks… Highly leveraged transactions may experience substantial gains or losses in value as a result of relatively small changes in the value or level of an underlying or related market factors") does not apply to circumstances such as this.

(6) Whether requiring the Transport Companies to continue to perform their obligations under the swaps would be a serious breach of the principles of good faith

636. Professor da Frada and Professor Câmara are broadly in agreement that this requirement applies if performance has become excessively hard and its maintenance would lead to a result contrary to both law and justice. As both parties' closing submissions implicitly recognised, the conclusion on this issue goes with the earlier conclusions.

637. In the language used in the cases, the court agrees with the Transport Companies that the consequence of the GFC and its effect on interest rates has resulted in a financial imbalance between the parties to the swaps, adversely affecting the equilibrium of the contracts. Requiring the Transport Companies to continue to perform their obligations under the swaps would require them, and them alone, to bear the burden of the adverse effects of the GFC, which, applying Art. 437 of the Civil Code, as the Portuguese Supreme Court put it in its judgment of 10 October 2013, would be "contrary to what good faith dictates".

638. For the avoidance of doubt, this has nothing to do with the parties' good faith when the contracts were entered into. These were always very risky contracts, but having seen the bank officers testify, the court is satisfied that they never foresaw that the bank would become entitled or the Transport Companies liable to payment at these massive rates.

639. As Mr José Manuel Alves Elias da Costa, Head of BSNP between 2002 and 2008, and who was involved with maintaining the client relationship with Transport Companies at a senior level, told the Parliamentary enquiry, "At the time this structure was contracted the possibility of the 2% barrier being breached was practically nil".

640. In the light of what has happened, the court finds that as a matter of Portuguese law, requiring the Transport Companies to continue to perform their obligations under the swaps would be a serious breach of the principles of good faith within the meaning of Art. 437.

641. It follows that if Portuguese law had applied to the swaps, the court would have upheld the Transport Companies' case that the requirements of Art. 437 of the Civil

Code are satisfied. Applying Professor Câmara's test, there has been an unpredictable and extraordinary change that gravely affects the performance of one of the parties.

Remedies

642. Had the court found in favour of the Transport Companies on this issue, the question would have arisen whether they are entitled to termination of the swaps and, if so, from what date(s), or whether modification should apply. The possibility of modification arises from the terms of Art. 437(2) which is set out above.

643. In the event, both parties told the court in closing that if it found in favour of the Transport Companies, the question of remedy should be dealt with at a subsequent hearing.

644. The court will therefore limit itself to the following comments on the issue of remedy. It is common ground that where Art. 437 applies, priority is given to contractual modification over termination. A solution which is fair to both sides could be fashioned, in the court's view. It is also common ground that it would be open to the English court to modify the swaps if Art. 437 were engaged—though not entirely free from doubt, this seems a sensible approach[49], and the court does not demur from the position adopted by the parties.

PART I: THE SECURITIES CODE ISSUE

Introduction

645. This issue concerns breaches asserted by the Transport Companies on the part of BST of certain provisions of the Securities Code, being provisions which apply to derivatives such as swaps. It is not in dispute that these provisions are mandatory—see above.

646. The Securities Code is a central component of securities law in Portugal, the current code being that adopted in 1999, which has since been amended on various occasions.

647. The Code followed the implementation in Portuguese law of the then applicable European legislation, namely the Investment Services Directive (Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field). The ISD established the conditions under which authorised investment firms and banks could provide specified services in other EU member states, and relevantly for present purposes, included harmonised conduct of business rules.

648. Substantial changes in the code were required by the Markets in Financial Instruments Directive (Directive 2004/39/EC) which is invariably referred to as MiFID, which replaced the Investment Services Directive as of the effective date, 1 November 2007.

649. It is not in dispute that whereas the ISD was an instrument of "minimum harmonisation" which could be implemented in national law with higher standards, MiFID is an instrument of "maximum harmonisation", intended to apply a "level playing field" through the European Union in the areas it covers.

[49] *Cox v Ergo Versicherung AG* [2014] UKSC 22 at [23], Lord Sumption.

The articles of the Securities Code on which the claim is based

650. The relevant part of the text of Arts. 304 and 309 Securities Code (as set out in the 2006 version) on which the Transport Companies' claim is based is as follows:

> "304 Principles
>
> 1. Financial intermediaries should conduct their activity so as to protect the legitimate interests of their clients and the efficiency of the market.
>
> 2. In their relations with all market participants, financial intermediaries should observe the rule of good faith, in accordance with high standards of diligence, loyalty and transparency.
>
> 309 Conflicts of Interest
>
> 1. The financial intermediary should organise itself and act so as to avoid or reduce to a minimum the risk of conflicts of interest.
>
> ...
>
> 3. The financial intermediary should give preference to clients' interests, be it with regard to its own interests or companies with which it has a control or group relationship, as well as with regard to the interests of its directors and employees."

The issues

651. The Transport Companies' claim for breach of these articles was articulated as a composite claim—in other words, it tends to read the articles together. In its analysis, BST tends to read the articles separately. However, the same issues arise, and the court will follows the Transport Companies' structure in this respect. The issues are:

(1) Was BST under any duty to the Transport Companies when it acted as a financial intermediary on its own account, other than under Art. 312 of the Securities Code? Art. 312 deals with duties of disclosure.

(2) If so, did BST act in breach of those duties?

(3) Is BST entitled to rely on a limitation defence to the Transport Companies' claims?

(4) Did the Transport Companies cause and/or contribute to their losses?

(5) Is MdP entitled to rescission in respect of the 2nd MdP Swap? In relation to the Transport Companies' claims for damages in respect of the other swaps, it is common ground that breach of a financial intermediary's duties under the Securities Code gives rise to a claim for damages. MdP does not allege that it

has suffered loss or damage under its second swap, but rather claims rescission of MdP 2 under Art. 562 Civil Code.

The Transport Companies' contentions summarised

652. It is the Transport Companies' case that BST acted in breach of its duties as a financial intermediary under Arts. 304 and 309 of the Securities Code. In putting forward the swaps to them, which were both incapable of performing the interest rate risk management function that was their purported purpose and which were significantly imbalanced in favour of BST, BST acted in breach of its duties as a financial intermediary to act: (a) so as to protect its client's legitimate interests and/or observe the rules of good faith in accordance with high standards of loyalty (as required by Arts. 304(1) and 304(2) of the Code); and/or (b) so as to minimise the risk of conflicts of interest and to give preference to its client's interests over its own (as required by Arts. 309(1) and 309(3) of the Code).

653. The Transport Companies submit that on a proper understanding of these provisions, BST is wrong to contend that insofar as Art. 304 applies at all, it is satisfied by BST's compliance with Art. 312 (Duties of Information). As a financial intermediary, it was under a pre-contractual duty of good faith and loyalty to them in relation to the swaps and was therefore under the statutory duties imposed by Arts. 304(1), 304(2) and 309 of the Securities Code.

654. The Transport Companies' case is that the circumstances of the swaps and their presentation to the Transport Companies were exceptional and that, in these exceptional circumstances, BST acted in breach of its pre-contractual duties of good faith and loyalty as imposed by Art. 304 and in breach of its duty under Art. 309 to manage its conflicts of interest when it proposed these instruments to the Transport Companies. BST knew – or ought to have known – better and, just as an intermediary is obliged to refuse to execute an order under Art. 326 of the Code when it is contrary to the intentions of the entity placing the order, so BST was obliged not to have proposed these instruments to the Transport Companies, when they were so contrary to their objectives. In doing so, BST acted contrary to its pre-contractual duties of good faith and loyalty imposed by Portuguese law under (and so in breach of) Arts. 304(1), 304(2) and 309 of the Securities Code.

655. In summary, these "exceptional circumstances" were that (1) BST did not act as a "pure" principal-to-principal counterparty in its dealings with the Transport Companies presenting itself as their "partner", (2) BST presented the swaps as instruments of "financial risk management" when they were not, but were speculative and risky, (3) BST knew the extent (if not the full extent) of the risks that the Transport Companies would run by entering the swaps, (4) BST knew that the Transport Companies provided services of public importance, that the fares they could charge were restricted by the State, and that if they sustained the losses that BST calculated they might suffer, they would have to look to the State, (5) BST knew – or ought to have known – that the Transport Companies had no experience of leveraged, snowball swaps; by comparison with the ordinary consumer, the Transport Companies may have been sophisticated; by comparison with BST – which is the right comparator – they were not, (6) BST knew – or ought to have known – that the Transport Companies, whilst they might have understood mathematically how the formulae in the swaps worked, did not appreciate the risks that they were running, (7)

BST stood to gain considerable profits from the swaps, and BST's interests and the Transport Companies' interests were in direct conflict.

656. As a result, the Transport Companies assert that they have suffered loss and damage in respect of eight of the nine swaps, which they claim from BST. (No damage is alleged in relation to the MdP 2 swap, which MdP claims to be entitled to rescind by way of a remedy under Art. 562 Civil Code.)

BST's contentions summarised

657. BST's case is that when transacting swaps on own account, as in the present transactions, it did not have a duty not to propose or contract swaps based on an evaluation of their suitability for the client. When entering into a transaction with a client on own account, the general duties in Art. 304 are satisfied by compliance with the information duties in Art. 312. If a bank transacts a swap with a client (at least in the absence of deceiving the client) the bank is not thereby put in breach of its conflict of interest duties or to prefer their clients' interests with regard to their own. It was for the Transport Companies themselves, not BST, to reach a decision whether or not to contract the swaps.

658. The Transport Companies were sophisticated financial operators with highly experienced finance departments and a wealth of financial expertise within their respective boards, having entered into numerous swaps prior to the swaps. As a result, they well understood the terms of the swaps and the operation and risks of the snowball mechanism, in particular that spreads would accumulate upon a breach of the relevant barriers and that liability was potentially uncapped. They understood that the swaps offered a greater reward in return for these risks, and reached the view that, on balance, entering into them would further their legitimate interests, namely to protect against rising rates and reduce their cost of funds, within the relevant barriers.

659. When a firm contracts with a client as a counterparty, no duty to prefer the client's interests arises and where a client freely enters into a contract with a firm, and knows the firm is dealing as its counterparty, this does not put the firm into a position of conflict of interest under Art. 309. The situation is one under which the firm is required to be transparent about the transaction, but the client is free to make up its own mind and is bound by the consequences of an investment which is freely made with the firm.

660. As to Art. 304, in the context of dealing on own account, the only concrete inference of the duty of good faith and loyalty is the disclosure duty; and the requirement of putting other people's interests above one's own cannot apply to own-account dealing.

661. In any event, BST asserts that all of the Securities Code claims are time-barred, and that even if BST were liable, the claims made by the Transport Companies would fall to be reduced under Art. 570 Civil Code by virtue of (1) their failure to have proper regard to protecting their own interests when entering into the swaps (c.f. English contributory fault defence), (2) savings achieved by MdP and MdL in entering into further instruments with third parties to hedge and reduce their liability under the swaps, and (3) the Transport Companies' failure further to mitigate or avoid the losses

suffered by them. The validity of each of these additional assertions is also denied by the Transport Companies.

The Transport Companies' pleaded case

662. The parties were in dispute at the end of the trial as to the scope of the Transport Companies' pleaded case. The essence of the dispute goes to whether the Transport Companies are entitled to rely on any assertion that they did not appreciate the risks they were running on entering into the swaps, and BST's awareness of this said to have arisen from BST's failure to provide them with relevant information. This argument arose over the seven factors in the section on "exceptional circumstances" in the Transport Companies' written closing submissions—these are summarised above.

663. The factor which BST in particular objects to asserts that:

> "Sixth, BST knew – or ought to have known – that the Transport Companies, whilst they might have understood mathematically how the formulae in the Swaps worked, did not appreciate the risks that they were running. BST knew or ought to have known that from the fact that it did not inform the Transport Companies of the RECs or the initial MtMs and that the Transport Companies did not have the internal capability to calculate either. It knew or ought to have known that from the fact that BST (other than in relation to 3 Swaps) did not provide the Transport Companies with any stress testing …. It knew or ought to have known that from such matters as the fact that it (BST) itself informed e.g. Carris in relation to the First Carris Swap that the risk of the barriers being exceeded was "predicted to be of null value" … and the fact that Pedro Pinto for MdP considered in relation to the First MdP Swap that the digi-coupon was an effective risk mitigator, whereas clearly it was not …".

664. In short, BST says that the Transport Companies have gone beyond their pleaded case which does not assert any such lack of understanding or lack of information. As it put it in its written closing submissions, this is not a case where any complaint is made about the information provided by the bank being either inaccurate or inadequate in order to enable the Transport Companies to understand both the transactions and the nature of the risks involved.

665. The Transport Companies respond that it is BST that has put their supposed financial sophistication on the agenda, and that they are entitled to meet this allegation, and rely on the case to the contrary.

666. In considering these submissions, the starting point is the Transport Companies pleaded case as to breach. This is that:

> "49. BST acted in breach of the said duties in that:

> 49.1. By reason of the matters pleaded in paragraph 36.3 and 36.4 above, in the event that the relevant reference rates did not perform in accordance with market expectations, BST stood to profit significantly from the Swaps, whereas Carris had no prospect of limiting its cost of funds and was in fact exposed to the risk of unlimited and exponentially increasing interest rates.
>
> 49.2. In the circumstances:
>
> 49.2.1 BST gave preference to its interest in making a profit on the Swaps over Carris's interest in limiting its cost of funds;
>
> 49.2.2 BST failed to protect Carris's interests; and/or
>
> 49.2.3 BST failed to act in good faith and/or in accordance with high standards of loyalty."

667. Paraphrasing paragraph 49, the pleaded case is that in the event that the relevant reference rates did not perform in accordance with market expectations, BST stood to profit significantly whereas the Transport Companies were completely exposed, and so in the circumstances (1) BST gave preference to its own interest, (2) failed to protect the Transport Companies' interests, and (3) failed to act in good faith and/or in accordance with high standards of loyalty. Sub-paragraph (1) is directed at Art. 309(3), and the remaining sub-paragraphs at Art. 304.

668. In its Reply to BST's Defence to Counterclaim, it is further pleaded that BST was in breach, "by proposing the Swaps to Carris, which were not in Carris's interests …". It is therefore the Transport Companies' case that BST was in breach in proposing the swaps to the Transport Companies.

669. All these extracts are from the Carris pleadings, those of the other companies being the same.

670. BST maintains that this pleading excludes any case of breach of the Securities Code based on a failure on its part to explain the swaps, or a failure on the part of the Transport Companies to understand them based on a failure to provide information. This was plainly put in BST's written opening submissions at the start of the trial:

> "It must be stressed that (as the TCs themselves put it) "there is no allegation of mis-selling in the present case". Their complaint is not that any of the Swaps, or their respective characteristics, were misrepresented to them, or imperfectly understood by them. They likewise raise no allegation that BST owed or breached any advisory duty. Nor do the TCs allege that BST failed to provide them with relevant information about the Swaps. Similarly, they do not contend that their experience or expertise in relation to financial transactions was insufficient for the Swaps to be appropriate for them. In short, all the normal elements of a financial mis-selling claim are absent …".

671. In response, the Transport Companies maintain that the duty of good faith under Art. 304, and the duties under Art. 309, are adapted in any given situation, and that the factual background is important therefore when assessing whether, as the Transport Companies allege, BST acted contrary to these duties. The factual background is obviously a matter of evidence, and that evidence will develop in the course of the trial. They submit that there is no pleading objection to their case as put in closing submissions when one takes into account an understanding of how the factual background has emerged in the evidence, and the findings of fact sought by BST itself.

672. The court agrees with the Transport Companies that BST has sought to emphasise (to quote from its closing submissions) that the Transport Companies "were sophisticated financial operators". The relevant submissions are set out above. The Transport Companies are right to say that they are entitled to challenge this assertion, and ask the court to make factual findings (which the court has done above), and rely on those findings.

673. Nevertheless, it is a feature of the conduct of business rules in MiFID and its ISD predecessor that they are stated at a high level of generality. Where a claim is brought based on breach of the rules, here breach of its implementation in national law by way of the Securities Code, it is important that the claimant clearly pleads the nature of the breach alleged. Unless the case is clearly spelled out, there is a danger that the claim becomes a moving target.

674. The court agrees with BST that in essence the Transport Companies' pleaded case is that "the reason that you have acted in breach of these obligations is because you entered into a transaction that led to us having potentially unlimited liability in circumstances where you were going to make a profit". It is similarly summarised in paragraph 471 of the Transport Companies' written opening submissions.

675. There is no pleaded case based on a failure on their part to understand the swaps, or that BST "knew or ought to have known this" based on a failure to provide information which should have been provided. The evidence, perhaps disclosure (though this already was very extensive), arguments, etc., may have been different if there had been. The court accepts BST's submission that it would not be right to allow such a case to be advanced now.

676. In any event, the court does not accept the factual premises of the Transport Companies' closing submissions. This is dealt with further below.

The expert evidence

677. The expert evidence was given by Professor da Frada for the Transport Companies, and Professor Câmara for BST. The court refers to what it said above as to these two good witnesses. Here, in a sense, the table is turned, because the subject matter of the Securities Code issue is in the specialist area of financial regulatory law, and specifically the effect of provisions deriving from the Investment Services Directive/MiFID. Professor Câmara has spent most of his professional career in this field with the Portuguese Securities Commission and thereafter in private practice.

678. By contrast, Professor da Frada is pre-eminent in Portugal in the field of private law, and financial regulation is not within his particular area of expertise. His evidence that there was nothing in the Securities Code on the subject of "own account" dealing was incorrect, since a chapter of Title VI is concerned with 'Dealing on own account'. The court does not accept the Transport Companies' assertion that Professor Câmara's evidence was not directed to the particular facts of the situation the court has to consider. On this issue, save where otherwise stated, the court prefers his evidence.

BST duties when it acted as a financial intermediary on its own account

(*i*) *The experts' opinions*

679. It is common ground that the regulatory classification of the Transport Companies does not affect the scope of the duties owed by BST.

680. It is also common ground that, when BST entered the swaps, it did so as principal on its own account. In other words, in their contractual dealing, BST and the Transport Companies contracted on a principal to principal basis. The bank acted on its own account, and not as agent, or adviser. The evidence is that this is how the OTC swaps market operates.

681. It is also common ground that, when it did so, BST was acting as a "financial intermediary" within the meaning of the ISD and the Securities Code. Art. 304 applies to a diverse range of activities of financial intermediaries, including executing transactions for clients, advice and portfolio management, corporate finance, and, the relevant category here, "dealing for own account", as when a bank executes a swap with a counterparty. In the latter case, the relevant activity is defined in the Annex to the ISD as "Dealing in any of the instruments listed in Section B [which includes interest rate swaps] for own account". (The term used in the equivalent Annex to MiFID is "dealing on own account".)

682. As the Transport Companies say, Professor Câmara draws a distinction between an "investment service", which is said to amount to a fiduciary service, and an "investment activity", which does not. They say that this distinction is Professor Câmara's personal gloss on the Securities Code, and has no support in the code itself, and results in difficulties and contradictions, arising from the terms of the Investment Services Directive, and its implementation in the Securities Code.

683. It is also said to result in an inconsistent approach to the requirement of good faith. The Transport Companies' case is that Professor da Frada's interpretation of Art. 304(2) of the Securities Code ensures the general application of Art. 227 of the Civil Code (which requires the observance of good faith in pre-contractual relations).

684. They contend that if Professor Câmara were to accept (as Professor da Frada accepts and the Transport Companies contend), that Arts. 304(1), 304(2) and 309 apply in full to financial intermediaries at all times, albeit with varying "intensities", depending on the relationship between the intermediary and the client and the particular fact situation, none of these difficulties and contradictions would arise.

685. They contend that the material in support of the non-application (as opposed to the level or “intensity” of application) of these duties is unconvincing. They submit that:

(1) The fact that “acting on [one’s] own account” has a separate chapter in the Securities Code is no evidence that this activity is to be dealt with differently.

(2) A decision of the Lisbon Court of Appeal of 13 May 2013 (309.11.8TVLSB.L1-7) which Professor Câmara considers supports his view that Art. 312 states the financial intermediary’s duties in own account dealing, properly interpreted, shows that the court adopted a fact-specific approach.

(3) Academic writing provides no support for his position, which is not emphasised in his own text book.

(4) As regards BST’s contention that the financial intermediary is not in a position of conflicting duties when dealing on own account, this presupposes that the financial intermediary is not subject to a duty of loyalty under Art. 304(2). Professor Câmara’s views involve “writing out” the reference in Art. 304(2) to “high standards of ... loyalty” when it applies to a financial intermediary acting on its own account, which is impermissible. Accordingly, this is a conflict of interest situation, and Art. 309 also applies.

686. The Transport Companies’ case (based on Professor da Frada’s evidence as to the particular standards which are applied in Portuguese law) is that BST as a financial intermediary was under a pre-contractual duty of good faith and loyalty to the Transport Companies in relation to the swaps, and was therefore under the statutory duties imposed by Arts. 304(1), 304(2) and 309 of the Securities Code.

687. As regards Art. 304, the Transport Companies argue that BST is wrong in its contentions based on the fact that they did not give BST a mandate to decide on their behalf whether or not to enter the swaps. It does not follow, they say, that “there is no scope for any contention that BST owed … an ‘evaluative duty or duty not to propose or contract swaps’. It is precisely such a duty – or as the Transport Companies would say, remedy – that the pre-MiFID Securities Code does contemplate”.

688. BST’s case (based on Professor Câmara’s evidence) is as follows. The range of financial activities which is subject to regulation in Portugal, it submits, as in the rest of the EU, is heterogeneous, but distinguishes between (1) services which a firm renders on the client’s behalf; and (2) others that are not rendered on the client’s behalf. This was the case at all relevant times for these proceedings, whether pre or post MiFID.

689. MiFID, and the post-MiFID Securities Code, it submits, reflect a progressive articulation of categories of investment *activities* which are performed by a financial intermediary on its own account, on the one hand, and investment *services* which it provides on its client’s behalf, on the other hand. Under this regime, in the case of investment *activities*, the firm does not act on behalf of the client—it acts in the financial firm’s own interest and behalf. Therefore, agency duties, such as the duty to put the client’s interests before the firm’s interests (as Art. 309(2) contemplates), do not arise when acting on own account (such as when executing an OTC swap trade as counterparty or principal), as the deal is contracted on a principal to principal basis.

(ii) The court's findings

690. The court's findings on the opposing contentions are as follows:

(1) It accepts Professor da Frada's evidence as to the importance of good faith in pre-contractual negotiations, based as it is on the doctrine of *culpa in contrahendo*.

(2) He also says that although in Portuguese law pre-contractual duties vary in their scope, they do so "not by reference to the nature of the parties' relationship, but according to the material equality that exists between them when conducting their negotiations".

(3) However, the court prefers Professor Câmara's approach on this issue. He points out that the particular duties identified by the Transport Companies as applicable in this case are derived from European legislation, including MiFID, which the Securities Code implements.

691. Nor does there seem much basis for the duties contended for:

(1) The Transport Companies' case is that BST was under a duty not to propose or contract the swaps.

(2) A route by which Professor da Frada concludes that BST was in breach in proposing the swaps is Art. 326(1)(b) of the Securities Code. This provides that, "The financial intermediary should refuse an order when: .... b) it is evident that the operation is contrary to the intentions of the entity placing the order, unless the entity confirms the order in writing".

(3) Based on this, the Transport Companies say that there can be no "in principle" objection to requiring BST to be under a duty not to propose financial instruments when they are manifestly incapable of performing the purpose for which they were intended, namely to be instruments of financial risk management.

(4) The court disagrees. Art. 326 is concerned with a completely different topic, namely the execution of orders.

(5) The sub-paragraph relied on concerns the situation where there are questions as to whether the entity placing an order intended to do so.

(6) In the own account situation, it gives no support to any duty on the part of the financial intermediary not to propose or contract swaps as contended for by the Transport Companies.

692. The Transport Companies argue that BST should itself have assessed whether the swaps were appropriate and warned the Transport Companies accordingly. But on that basis, the evaluative duty they contend for becomes indistinguishable from a duty to advise, which they themselves make clear they do not assert.

693. Broadly, the court would accept the distinction drawn by Professor Câmara between "activities" and "services". But the key point is a functional one—when a bank is

acting on its own account, its duties to the counterparty under EU legislation (or its national implementation) are commensurate with that relationship. There is no room for applying a rule relating to conflicts of interest in this situation. Where a bank is dealing on its own account, plainly it cannot be expected to give preference to the counterparty's interests over its own. In the case of an interest rate swap, by definition, a movement in interest rates that is positive for one party, will be negative for the other. This distinguishes the situation from one (for example) in which the bank is carrying out a service on behalf of a client, or acting in a discretionary or advisory capacity, where conflicts of interest can arise.

694. The court is satisfied that this is equally the position under Portuguese law, and does not accept Professor da Frada's evidence so far as it was to the contrary.

695. It finds support in the decision of the Lisbon Court of Appeal of 13 May 2013, which also involved an interest rate swap. As the court put it, "we do not see how it can be claimed that there is a conflict of interests which the Defendant Bank did not know how (or did not want) to avoid or reduce, to give priority to the client's interests". This goes further than a finding on the particular facts, as the Transport Companies suggest.

696. The Transport Companies cite the judgment of the Supreme Court of 10 January 2013 (89/10.4TVPRT.P1.S1) recording the Plaintiff as stating that Art. 304(2) provides a "*diligentissimus pater familias*" standard. But Professor Câmara did not agree that this applied in an own account case, and the court accepts his evidence.

697. The court further accepts that in this situation there is no duty to advise as to the suitability of the swaps for the client:

(1) On the proper application of the Securities Code, when entering into a swaps transaction with a client on own account, so far as relevant in the circumstances of this case, the general duties in Art. 304 are satisfied by compliance with the information duties in Art. 312 ("Duties of Information").

(2) Though Professor da Frada is of the opinion that contractual fairness cannot be guaranteed by a purely informational model of regulation in the interests of investor protection, for the reasons given, this depends on the relationship between them.

(3) Of course, the position would be different if there had been any misrepresentations by the bank, or if the client was relying on the bank for advice, but the Transport Companies do not allege this.

698. There is no support for their contention that Art. 304 has the effect that if the swaps were "manifestly disproportionately" in BST's favour, they ought never to have been proposed to the Transport Companies, and the court rejects the contention. It finds that the bank had the duties of transparency required by Art. 312, but that as a matter of Portuguese law, it was for the Transport Companies themselves, not BST, to reach a decision as to whether or not they contracted the swaps.

Breach of duty under the Securities Code

699. On the pleaded case, no question of breach arises. The court has upheld BST's submission that the alleged duties under the Securities Code do not exist. It follows that there was no breach of duty in proposing these swaps.

700. That finding sits with the evidence as a whole. BST was told that MdL was speaking to a number of competing banks in order to find the structure that was most favourable to it. As BST says, the circumstances in which the swaps were concluded included competition between various banks for the Transport Companies' business. They entered into the swaps that they considered were best—it is a reasonable inference that if BST had not proposed the swaps, other banks would have done so. Contrary to the Transport Companies' submissions, for reasons given earlier, the swaps were capable of performing their purpose.

701. In closing, the Transport Companies emphasised what they contend were the exceptional circumstances of the swaps and their presentation. They say that in these exceptional circumstances, the court should find that BST acted in breach of its pre-contractual duties of good faith and loyalty as imposed by Art. 304 and in breach of its duty under Art. 309 to manage its conflicts of interest when it proposed these instruments to the Transport Companies. They say, "In short, BST knew – or ought to have known – better …".

702. For reasons set out above, it is not open to the Transport Companies to advance a case under the Securities Code based on the exceptional circumstances here set out, centrally, the asserted failure on their part to understand the swaps where BST knew or ought to have known that they could not do so.

703. The "exceptional circumstances" relied on by the Transport Companies are summarised above. The factual points made are picked up elsewhere in this judgment where necessary. There are two to mention specifically here.

704. The Transport Companies contend that BST did not act as a "pure" principal-to-principal counterparty in its dealings with the Transport Companies presenting itself as their "partner". This is based on the report of the New Products Committee of 20 June 2007 referred to above. However, this does not provide any foundation for a submission that the parties were not acting on a principal-to-principal basis.

705. As explained above, the Transport Companies sought to contend that BST knew the extent (if not the full extent) of the risks that the Transport Companies would run by entering the swaps, and knew – or ought to have known – that the Transport Companies, whilst they might have understood mathematically how the formulae in the swaps worked, did not appreciate the risks that they were running.

706. Reliance is placed on a number of points. It is said that BST knew or ought to have known that from the fact that it did not inform the Transport Companies of the RECs or the initial MtMs and that the Transport Companies did not have the internal capability to calculate either. The court does not accept this. BST was not under a duty to provide this information, and it did not anticipate the risks that followed from the financial crisis.

707. The court has dealt with the "predictions of null value" and the fact that Mr Pinto considered in relation to the first MdP swap that the digi-coupon was an effective risk mitigator, and need add nothing here.

708. Reliance is also placed on the fact that BST (other than in relation to three swaps) did not provide the Transport Companies with any stress testing. The facts are set out above.

709. However, for reasons set out above, the court finds that there cannot have been any real doubt on the part of the Transport Companies about the scale of the risks that these swaps entailed. The position as to stress testing does not in the court's view affect that conclusion. This formulation of the Securities Code claim put in closing submissions would not therefore have succeeded on the facts even if it had been pleaded.

Limitation

710. In the circumstances, BST's assertion that the claims are time barred, as having been begun outside the three year period in respect of tortious claims under Art. 498(1) of the Civil Code, or the two year period under Art. 324 of the Securities Code, does not arise.

711. However, since BST placed some emphasis on limitation in its closing submissions, the court expresses its conclusions as follows.

712. BST argues that the Transport Companies would have known the factual prerequisites for a claim for compensation as at any and all of the following dates—the date of the conclusion of the swaps themselves; the date on which the Transport Companies were first informed that the swaps had any negative mark to market value; the date the Transport Companies were first informed that the swaps had very substantial negative MtMs; the date on which the Transport Companies first found themselves paying more out under the swaps than they were receiving. All were outside the limitation period calculated from the dates the claims were made in these proceedings, which as stated above were commenced in May 2013.

713. Had the issue arisen, the court would have found for the Transport Companies. BST's submission that time started running at the date of the conclusion of the swaps is not realistic.

714. As it was put by the Transport Companies, if that is right, it begs the question why they entered into the swaps in the first place, unless they had some kind of urge to damage themselves.

715. The problem with the alternatives proposed by BST is that the circumstances obtaining in the financial crisis were so unusual that bright line dates do not hold good.

716. The court would have upheld the Transport Companies on this point, preferring in this regard (so far as it is a matter of Portuguese law) the evidence of Professor da Frada, holding that they did not know the permanent nature of the damage that they had suffered until it became clear that the GFC was no ordinary recession. This was not

the case until the second half of 2011, with the consequence that whether the two or three year limitation period applies, time had not run.

Other issues

717. Given its above conclusions, the court need not make a finding on certain other issues between the parties, being BST's assertions that damages should be reduced on the basis that the Transport Companies caused and/or contributed to their losses, and the Transport Companies' assertion that MdP is entitled to rescission in respect of MdP2—it suffered no loss in this case, since there was no lower barrier (BST says that the English court cannot give this remedy as being a form of compensation for tort which is not available in English law).

718. If this is still pursued, the court need not make a finding either as to whether BST is entitled to rely on the representations in the ISDA Master Agreement so as to exclude or limit its duties under the Securities Code in respect of the sale of the STCP swap. From 1 November 2007 (when MiFID came into effect) STCP was classified as a "qualified investor". The trade date of 2 November 2007 is on the face of it the relevant date (though the Transport Companies rely on the fact that the proposal was made on 24 October 2007 followed prior to 1 November by some other pre-trade steps).

PART J: REMEDIES

719. The remedies each party seeks are set out at the beginning of this judgment.

720. The subject was addressed briefly by the parties in written closings, but neither party dealt with remedies in oral closings, and these were effectively left over to be determined in the light of the court's findings.

721. The remedies sought by BST in the event of it succeeding on the above issues, as it has, are not understood to give rise to particular issues, though questions such as interest remain to be decided, and there will need to be a careful formulation of the court's order.

722. BST raised issues as to the Transport Companies' claims for restitution and damages and other relief had their claims succeeded, and it is sufficient to note these:

(1) There was an issue as to whether the governing law of their restitution claim was English law (per BST) or Portuguese law (per the Transport Companies).

(2) On the basis that English law applied to the restitutionary claim, BST argued that it was not liable because the enrichment was not unjust, there had been a change of position, and in any case credit needed to be given for the benefit said to have been received because the MdL swaps were restructurings.

(3) On the basis that Portuguese law applied to the restitutionary claim, BST challenged the right to interest, and similarly said that credit needed to be given for the benefit said to have been received because the MdL swaps were restructurings.

(4) In relation to the damages claim under the Securities Code, BST raised the issue of avoided loss, contributory fault and failure to mitigate (see above).

(5) As to rescission in relation to MdP 2, see above.

PART K: CONCLUSION

The facts

723. An outline of the facts is contained in the introduction. The court's detailed findings of fact are set out above. There are some particularly significant factual findings which are summarised here.

724. These swaps were very risky. This is because, although the transaction experts agree that at inception the swaps overall had a probability of 72% of providing a potential benefit to the Transport Companies over their life, these were long-term swaps, and there was obviously a risk that interest rates would breach the upper or lower barrier, and might do so for substantial periods of time. The effect would be magnified by the leverage and accumulation contained in the "snowball" structure of the swaps.

725. Because of the risk, there were concerns in Santander Spain over the sale of "snowball" swaps to public sector companies in Portugal. However, Santander Spain was not directly involved with the negotiating or transacting of these swaps, which was handled by the officers of the bank in Portugal.

726. An important question is why the parties entered into such risky swaps.

727. The court has made several criticisms of the bank by reference to disclosed contemporary documents. However, the officers concerned did not set out to persuade the Transport Companies to enter into contracts that they thought would be contrary to the companies' interests. In fact, the bank offered the companies alternative structures in a process in which it was in effect competing for business against various international banks. The Transport Companies do not allege and have never alleged that the bank misrepresented the position, or gave them negligent advice.

728. From the Transport Companies' perspective, they had extensive debt to manage. Their purpose in entering into the swaps was to reduce the amount of interest they were paying on the underlying transactions. These savings were in the early years largely achieved.

729. There was clearly a price to pay for the payment stream coming from the bank, and the risk was in effect the price. However, the companies' officers had no intention of speculating. The transactions were seen at the time as sound management of the companies' debt, this being a time when a very different attitude prevailed as regards such instruments than was the case after the financial crisis.

730. The swaps were seen as advantageous to the bank but also to the clients. They were entered into because they suited both parties: the bank got to enter into profitable transactions, and the Transport Companies got appreciably lower interest rates than they would otherwise have been paying.

731. A further question is whether the Transport Companies understood the risk when they entered into the swaps.

732. Whilst the expertise of the Transport Companies should not be underestimated (each company having a competent finance department), their expertise in the context of these swaps can be described as "adequate", rather than "sophisticated" as the bank has sought to argue.

733. It is doubtful that the Transport Companies, or for that matter the bank, fully appreciated the sensitivity of the mark to market value of the swaps to interest rate volatility. But it is not suggested that they were unaware that MtMs would have to be settled on any restructuring, and would reflect a trend in interest rates towards the barriers.

734. Overall, there cannot have been any real doubt on the part of those responsible within the Transport Companies for entering into the swaps about the scale of the risks that the swaps entailed. This did not require any great degree of financial sophistication.

735. The risk can now be seen in the light of subsequent events, but it is wrong to apply hindsight—at the time the risk was seen as acceptable.

736. However, what the parties did not, and could not, foresee was that as a result of the financial crisis, the reference interest rates would fall to near-zero for a sustained period that is still continuing. The economists' evidence shows that this is unprecedented.

737. These swaps were uniquely affected, because the effect of sustained near zero rates was magnified by the "snowball" structure. This also has had the result that the "mitigating features" have not taken effect.

738. Though this is not directly relevant to liability, when the swaps were entered into, all of which were long-term, there must have been a reasonable expectation on both sides that the Transport Companies would seek to manage the swaps, as part of the management of their debt, potentially including restructuring.

739. As the financial crisis set in, the bank tried to come up with restructuring solutions. But attempts to manage the swaps were ultimately unsuccessful because for a long time it was unclear whether it was in the Transport Companies' interests to terminate or restructure the swaps, or to wait. They did not act unreasonably in not terminating or restructuring the swaps within this time period.

The law

740. The court's task is to apply the law to the facts. The parties have identified the issues on which a ruling is required. In summary, the following are the court's principal findings with reference to the paragraphs above where the reasons are set out.

741. Many of the issues are issues of Portuguese law. The court expresses its appreciation for the jurists who gave expert evidence, and who expounded the wealth and depth of Portuguese jurisprudence and doctrine on the issues that arise for decision.

742. A Portuguese Framework Agreement had been used for earlier swaps, but by the time of these transactions, the parties had switched to ISDA documentation. The evidence is to the effect that this was a mutual decision, and reflected the position as regards other banks. The swaps were entered into under the ISDA Master Agreements and were subject to English law and jurisdiction.

743. The choice of law does not affect two of the issues which it is agreed are governed by Portuguese law. In this regard, the court has found that:

(1) The Transport Companies had legal capacity to enter into the swaps (the reasoning is set out in ¶¶ 247-343 above).

(2) In proposing/entering into the swaps, the bank was not in breach of the applicable provisions of the Portuguese Securities Code (the reasoning is set out in ¶¶ 645-718 above).

744. The outcome on the other two issues is dependent on the correct application of the rules as to applicable law.

745. The principle of freedom of choice of law in contract (or party autonomy) is recognised in European law.

746. This is subject to Art. 3(3) of the Rome Convention (now Art. 3(3) of the Rome I Regulation) which provides that where all the other elements relevant to the situation at the time of the choice are connected with one country only, the choice of law does not prejudice the application of rules of the law of that country which cannot be derogated from by contract (described as "mandatory rules").

747. A central dispute between the parties is whether Art. 3(3) applies in the circumstances of this case.

748. In the court's view, the legal test is as follows. For the purposes of Art. 3(3) of the Rome Convention (now Article 3(3) of the Rome I Regulation), in determining whether, choice of law aside, "all elements relevant to the situation are connected with one country only", the enquiry is not limited to elements that are local to another country, but includes elements that point directly from a purely domestic to an international situation. In financial transactions, the use of ISDA or other standard documentation used internationally may be relevant, and the fact that the transactions are part of a back-to-back chain involving other countries may also be relevant.

749. Applied to the facts of this case, because of the right to assign to a bank outside Portugal, the use of standard international documentation, the practical necessity for the relationship with a bank outside Portugal, the international nature of the swaps market in which the contracts were concluded, and the fact that back-to-back contracts were concluded with a bank outside Portugal in circumstances in which such hedging arrangements are routine, the court's conclusion is that Art. 3(3) of the Rome Convention is not engaged because all the elements relevant to the situation at the time of the choice were not connected with Portugal only. These were not purely domestic contracts. Any other conclusion would undermine legal certainty.

750. The other two Portuguese law defences do not arise for decision on this basis, but were fully argued. The court's findings are as follows.

751. The swaps are not "games of chance", or bets, so as to be void under the provisions of the Portuguese Civil Code (the reasoning is set out in ¶¶ 413-453 above).

752. In respect of the provisions of the Portuguese Civil Code as to "abnormal change of circumstances":

    (1) It is sufficient to take a rule out of Art. 3(3) of the Rome Convention if the rule can be disapplied by agreement between the parties after circumstances have arisen which allow one or other of the parties to rely upon it.

    (2) On this basis, the provisions are provisions that can be derogated from by contract; so for that additional reason, the provisions do not fall within Art. 3(3) of the Rome Convention (the reasoning is set out in ¶¶ 454-523 above).

    (3) Had the provisions as to abnormal change of circumstances been applicable, the Transport Companies would have been entitled to termination of seven of the nine swaps on this ground, subject to the court exercising its power to modify the terms of the swaps (the reasoning is set out in ¶¶ 524-641 above).

753. The court has made findings in favour of the bank and findings in favour of the Transport Companies. For the reasons set out above, the overall decision is in favour of the bank.

754. The court has decided the legal issues. This clarification may now enable the parties to move forward to resolve the difficult circumstances that have arisen between them.

755. This judgment will be followed by consequential submissions by the parties as to the form of the court's order.

756. The court expresses its appreciation to the parties for their assistance.

ANNEX

FIRST CARRIS Swap – Key Facts			
Basic Details			
Company type	Sociedade anónima (S.A.)	**Trade date**	10 November 2006
Date of ISDA Master Agreement	10 November 2006 (signed around 17 January 2007)	**Effective date**	15 September 2006
Date of confirmation of Swap	27 December 2006 (signed around 28 February 2007)	**Maturity period**	12.5 years
Amortisation profile	Amortises from €90,000,000.00 on calculation period commencing 15 September 2006 to €1,666,666.67 on calculation period ending 15 March 2019 (this is consistent with the amortisation profile of the underlying EIB Loans).	**Termination date**	15 March 2019
		Initial notional amount	€90,000,000.00
Underlying agreements details	Loan Agreements between EIB and Carris dated 17 December 2003 and 25 October 2005 for a total of €90,000,000.00 (EIB Loans)	**Outstanding notional amount**	€30,000,000.00[50]
		Underlying agreement rate	6M EURIBOR plus 0.13%
Swap Terms			
Receive leg	BST pays 6M EURIBOR semi-annually (on 15 March and September)	**Pay leg**	Carris pays quarterly (on 15 March, June, September and December): (i)For the payment dates from and including 15 December 2006 to and including 17 September 2007 = 1.835%; and (ii)For the payment dates from and including 17 December 2007 until maturity = 1.835% plus Spread
Spread	Previous Spread + 3.50 x [Max(2.75% - 10Y EURIBOR CMS IA, 0.00%)] + [3.50 x [Max(6M EURIBOR IA – 6.00%, 0.00%)]	**Other features**	The Spread is reset to zero for the payment date on 15 December 2011. The Swap has an early termination option for both BST and Carris which can be exercised between 9am and 11am 5 business days prior to the payment date on 15 September 2013 to terminate the swap on that date. If exercised the swap would be cash-settled at the mid market rates.
Explanation of the Spread: According to the Spread formula, the Spread is activated on the calculation date whenever the 10Y EURIBOR CMS IA rate falls below 2.75% or the 6M EURIBOR IA rate rises above 6%. The Spread is cumulative for payments from the payment date 17 December 2007, but is reset to zero for the payment date on 15 December 2011. There is a multiplying factor of 3.50 on activation of the Spread. For example, if the reference rate has moved 1.00% outside of one of the barriers, following application of the multiplying factor the Spread would increase by 3.50%.			
Current Valuation and Rate Information The MtMs of the Swap as per the statements BST sent to Carris are set out below.			
MtM value of the swap on the Trade Date	Approximately -€2.5m	**MtM value on 1 October 2015**	-€36,404,239
Interest rate	62.224%	**Interest rate**	6M EURIBOR (0.098%)

[50] As at payment date immediately prior to 1 October 2015.

payable on Pay leg on 1 October 2015		**payable on Receive Leg on 1 October 2015**	
First date on which Carris failed to make payment under the First Carris Swap	16 September 2013	**First date lower barrier crossed**	12 August 2010
		First payment date lower barrier crossed while Spread active	15 September 2010

First Carris Swap - Mark to Market Valuations

Date of MtM value	MtM / PV value[51]	Date of statement
29/12/2006	194,437	09/02/2007
31/12/2007	1,249,303	07/01/2008
30/05/2008	600,823	11/06/2008
30/06/2008	-11,904,066	03/07/2008
29/08/2008	-3,964,149	04/09/2008
30/09/2008	-7,363,654	07/10/2008
31/10/2008	-5,498,102	20/11/2008
28/11/2008	-8,707,097	03/12/2008
31/12/2008	-18, 271,962	05/01/2009
13/01/2009	-13,195,410	15/01/2009
20/01/2009	-11,644,818	26/01/2009
31/07/2009	-21,931,241	10/07/2009
31/08/2009	-20,892,346	04/09/2009
31/12/2009	-15,384,709	12/02/2010
26/02/2010	-12,689,680	08/03/2010
30/04/2010	-14,244,965	05/05/2010
31/05/2010	-19,262,661	04/06/2010
30/06/2010	-21,591,779	05/07/2010
31/08/2010	-40,434,334	03/09/2010
30/09/2010	-31,123,033	06/10/2010
29/10/2010	-25,371,056	04/11/2010
31/12/2010	-18,337,866	18/01/2011
31/01/2011	-18,732,416	03/02/2011
28/02/2011	-15,255,008	04/03/2011
31/03/2011	-12,064,245	08/04/2011
30/06/2011	-11,243,223	11/07/2011
29/07/2011	-15,745,021	05/08/2011
31/08/2011	-21,610,776	05/09/2011
30/09/2011	-32,074,959	06/10/2011
31/10/2011	-29,896,140	03/11/2011
30/11/2011	-26,231,292	05/12/2011

[51] All figures rounded to the nearest Euro

31/12/2011	-34,961,734	11/01/2012
31/01/2012	-36,641,217	06/02/2012
29/02/2012	-35,159,866	02/03/2012
30/03/2012	-32,983,833	03/04/2012
30/04/2012	-35,921,431	07/05/2012
31/05/2012	-67,259,136	05/06/2012
29/06/2012	-47,868,534	09/07/2012
31/07/2012	-56,823,371	06/08/2012
31/08/2012	-61,817,521	10/09/2012
28/09/2012	-57,362,642	10/10/2012
31/10/2012	-55,410,269	10/11/2012
30/11/2012	-59,891,829	05/12/2012
31/12/2012	-63,435,792	09/01/2013
31/01/2013	-51,494,716	08/02/2013
28/02/2013	-57,174,544	07/03/2013
28/03/2013	-58,698,853	11/04/2013

SECOND CARRIS SWAP – KEY FACTS			
Basic Details			
Company type	*Sociedade anónima* (S.A.)	**Trade date**	5 June 2007
Date of ISDA Master Agreement	10 November 2006 (signed around 17 January 2007)	**Effective date**	27 March 2007
Date of confirmation of Swap	5 June 2007 (signed around 17 March 2008)	**Maturity period**	9 years
Amortisation profile	Amortises from €100,000,000.00 on calculation period commencing 27 March 2007 to €12,500,000.00 on calculation period ending 29 March 2016 (this is consistent with the amortisation profile of the underlying Caixa Loan).	**Termination date**	27 March 2016
		Initial notional amount	€100,000,000.00
Underlying agreements details	Loan Agreement between Caixa and Carris dated 21 March 2006 for €100,000,000.00 (Caixa Loan)	**Outstanding notional amount**	€25,000,000.00[52]
		Underlying agreement rate	6M EURIBOR plus 0.45%
Swap Terms			
Receive leg	BST pays 6M EURIBOR semi-annually (on 27 March and September)	**Pay leg**	Carris pays quarterly (on 27 March, June, September and December): (i) For the payment dates from, and including, 27 June 2007 to, and including, 27 March 2008 = 2.720%; (ii) For the payment dates from, and including, 27 June 2008 to, and including, 27 March 2009 = 3.150%; and (iii) For the payment dates from, and including, 27 June 2009 until maturity = 2.950% plus Spread
Spread	Previous Spread + 2.50 x Max(0%; 2Y EURIBOR CMS IA – 10Y EURIBOR CMS IA)	**Other features**	The swap contains a switch option provision in favour of BST: starting on 27 March 2009, and on every payment date thereafter, BST has the option to switch Carris's payments to BST to 3M EURIBOR
Explanation of the Spread: According to the Spread formula, the Spread is activated on the payment date whenever the 10Y EURIBOR CMS IA rate falls below the 2Y EURIBOR CMS IA rate. The Spread is cumulative for payments from the payment date 29 June 2009. There is a multiplying factor of 2.50 on activation of the Spread. For example, if 10Y EURIBOR CMS IA rate falls below the 2Y			

[52] As at payment date immediately prior to 1 October 2015.

EURIBOR CMS IA rate by 1.00%, following application of the multiplying factor the Spread would increase by 2.50%.			
Current Valuation and Rate Information The MtMs of the Swap as per the statements BST sent to Carris are set out below.			
MtM value of the swap on the Trade Date	Approximately -€7m	**MtM value on 1 October 2015**	-€185,534
Interest rate payable on Pay leg on 1 October 2015	2.950%	**Interest rate payable on Receive Leg on 1 October 2015**	6M EURIBOR (0.088%)
First date on which Carris failed to make payment under the Second Carris Swap	27 September 2013	**First date 10Y EURIBOR CMS IA rate fell below 2Y EURIBOR CMS IA rate**	22 April 2008 (for one day). The 10Y rate fluctuated above and below the 2Y rate between April 2008 and October 2008, but has remained above since 2 October 2008.
		First payment date 10Y EURIBOR CMS IA rate fell below 2Y EURIBOR CMS IA rate while Spread active	N/A

Second Carris Swap - Mark to Market Valuations

Date of MtM value	MtM / PV value[53]	Date of statement
31/12/2007	-716,399	07/01/2008
30/05/2008	-2,446,443	11/06/2008
30/06/2008	-20,343,074	03/07/2008
29/08/2008	-13,374,347	04/09/2008
30/09/2008	-27,526,012	07/10/2008
31/10/2008	-5,571,776	20/11/2008
28/11/2008	-8,603,255	03/12/2008
31/12/2008	-21,294,081	05/01/2009
15/01/2009	-12,310,547	15/01/2009
20/01/2009	-11,627,112	26/01/2009
31/07/2009	-9,602,594	10/07/2009
31/08/2009	-9,769,113	04/09/2009
31/12/2009	-6,370,827	12/02/2010
26/02/2010	-6,750,856	08/03/2010
30/04/2010	-7,913,152	05/05/2010
31/05/2010	-9,282,793	04/06/2010
30/07/2010	-8,238,749	05/07/2010
31/08/2010	-9,361,451	03/09/2010

[53] All figures rounded to nearest Euro

30/09/2010	-8,532,911	06/10/2010
29/10/2010	-6,992,941	04/11/2010
31/12/2010	-5,680,274	18/01/2011
31/01/2011	-5,747,870	03/02/2011
28/02/2011	-6,093,468	04/03/2011
31/03/2011	-4,951,217	08/04/2011
30/06/2011	-3,699,005	11/07/2011
29/07/2011	-4,343,077	05/08/2011
31/08/2011	-5,540,489	05/09/2011
30/09/2011	-6,631,439	06/10/2011
30/09/2011	-6,631,439	06/10/2011
31/10/2011	-5,733,839	03/11/2011
30/11/2011	-5,290,104	05/12/2011
31/12/2011	-4,920,971	11/01/2012
31/01/2012	-4,795,744	06/02/2012
29/02/2012	-4,687,183	02/03/2012
30/03/2012	-4,665,007	03/04/2012
30/04/2012	-4,697,722	07/05/2012
31/05/2012	-5,531,024	05/06/2012
29/06/2012	-4,453,654	09/07/2012
31/07/2012	-4,849,999	06/08/2012
31/08/2012	-4,860,109	10/09/2012
28/09/2012	-4,554,041	10/10/2012
31/10/2012	-4,463,909	10/11/2012
30/11/2012	-4,498,442	05/12/2012
31/12/2012	-3,891,711	09/01/2013
31/01/2013	-3,555,785	08/02/2013
28/02/2013	-3,839,787	07/03/2013
28/03/2013	-3,364,578	11/04/2013

FIRST MdL SWAP – KEY FACTS			
Basic Details			
Company type	*Entidade pública empresarial* (E.P.E)	**Trade date**	6 June 2005
Date of ISDA Master Agreement	31 July 2002 (signed on 23 November 2005)	**Effective date**	23 September 2005
Date of confirmation of MdL 1 Swap	16 September 2005 (signed around January 2006)	**Maturity period**	17 years
Amortisation profile	The notional amount amortised over the life of the Swap from €99.24 million to € 54.45 million (this is consistent with the underlying Lease Agreement).	**Termination date**	23 September 2022
		Initial notional amount	€99,240,295.42
Underlying agreement details	Lease Agreement with Trem II – Aluguer de Material Circulante ACE dated 23 September 2002	**Outstanding notional amount**	€75,756,391[54]
		Underlying agreement rate	Linked to Euribor 6M
Swap Terms			
Receive leg	Euribor 6M – 0.71%, semi-annually (on 23 March and 23 September) This coupon is calculated with reference to the amortising notional amount.	**Pay leg**	MdL pays a coupon semi-annually (on 23 March and 23 September), which was fixed at 1.25% until 23 September 2009 and was thereafter fixed at 2.55%. MdL also agreed to pay BST a coupon on 23 March, 23 June, 23 September and 23 December. The coupon rate was zero for the first payment and was thereafter calculated according to the spread formula. This coupon is calculated with reference to the amortising notional amount and the floating amount was only applied to 89.65% of the notional amount.
Spread	Previous Coupon + Max (1.5% - USD Libor 3M, 0%) + Max (Euribor 3M - 8%, 0%)	**Upfront payment**	None
		Other features	None
Explanation of the Spread: According to the Spread formula, the Spread is activated on the calculation date whenever the 3M USD LIBOR rate was below 1.5% or the 3M EURIBOR rate was above 8%. For each quarter from the payment date 23 March 2006, the Spread payable would be added to the Spread for the previous quarter. The Spread was only applied to 89.65% of the notional amount.			
Current Valuation and Rate Information The MtMs of the Swap as per the statements BST sent to MdL are set out below.			
MtM value of the swap on the Trade	Mr Harkins calculates this as -€12,000,000. Mr Evans calculates this as	**MtM value on 1**	- €170,569,134

[54] As at payment date immediately prior to 1 October 2015.

Date	-€24,000,000.	**October 2015**	
Interest rate payable on Pay leg on 1 October 2015	32.1142%	**Interest rate payable on Receive Leg on 1 October 2015**	Euribor 6M – 0.71% (-0.616%)
First date on which STCP failed to make payment under swap	23 September 2013	**First date lower barrier crossed**	19 December 2008
		First payment date lower barrier crossed while Spread active	23 March 2009

First MdL Swap – Mark to Market Valuations

Date of MtM value	MtM / PV value[55]	Date of Statement
30/12/2005	-€9,749,346	13/03/2008
29/12/2006	-€13,331,371	13/03/2008
31/12/2007	-€9,950,250	13/03/2008
30/05/2008	-€4,659,016	12/06/2008
30/09/2008	-€18,610,433	09/10/2008
31/12/2008	-€64,953,441	05/12/2008
30/06/2009	-€51,225,564	06/07/2009
30/09/2009	-€72,090,673	06/10/2009
30/06/2010	-€103,458,014	09/07/2010
30/07/2010	-€110,094,305	04/08/2010
30/09/2010	-€124,954,404	06/10/2010
29/10/2010	-€125,428,679	05/11/2010
30/11/2010	-€126,895,911	06/12/2010
31/01/2011	-€120,386,902	09/02/2011
31/12/2010	-€114,955,814	13/01/2011
31/03/2011	-€111,925,541	08/04/2011
29/07/2011	-€142,900,477	05/08/2011
30/09/2011	-€161,194,761	06/10/2011
30/12/2011	-€158,371,265	09/01/2012
30/03/2012	-€165,900,432	03/04/2012
31/10/2012	-€190,995,304	06/11/2012
29/06/2012	-€173,512,679	09/07/2012
28/09/2012	-€193,763,870	10/10/2012
31/12/2012	-€189,315,250	06/02/2013
28/03/2013	-€185,458,916	11/04/2013

[55] All figures rounded to the nearest Euro

SECOND MDL SWAP – KEY FACTS			
Basic Details			
Company type	*Entidade pública empresarial* (E.P.E)	**Trade date**	22 September 2005
Date of ISDA Master Agreement	31 July 2002 (signed pm 23 November 2005)	**Effective date**	1 July 2005
Date of confirmation of MdL 2 Swap	19 October 2005 (signed around January 2006)	**Maturity period**	13.5 Years
Amortisation profile	The notional amount amortised over the life of the Swap from €92.50 million to €7.63 million.	**Termination date**	1 January 2019
		Initial notional amount	€92,497,211.72
Underlying agreement details	Sub-sublease Agreement with Stichting CBL Finance dated 31 December 1998	**Outstanding notional amount**	€29,927,430[56]
		Underlying agreement rate	Euribor 6M – 0.71% (originally 6M LISBOR)
Swap Terms			
Receive leg	Euribor 6M – 0.71%, semi-annually (on 1 January and 1 July) This coupon is calculated with reference to the amortising notional amount.	**Pay leg**	MdL pays a coupon semi-annually (on 1 January and 1 July), which was fixed at 1.44% to, and including, 1 January 2009 and was thereafter fixed at 3.67%. MdL also agreed to pay BST a coupon on 1 January, 1 April, 1 July and 1 October. The coupon rate was zero for the first payment and was thereafter calculated according to the spread formula. This coupon is calculated with reference to the amortising notional amount.
Spread	Previous Coupon + Max (Euribor 3M - 8%, 0%) + Max {Max(Euribor 3M -8%, 0%), Max (1.5%-USDLibor 3M, 0%)}	**Upfront payment**	None
		Other features	None
Explanation of the Spread: According to the Spread formula, the Spread is activated on the calculation date whenever the 3M USD LIBOR rate is below 1.5% or the 3M EURIBOR rate is above 8%. There is an implied multiplying factor on the upper barrier of 2; this arises whenever the upper barrier is breached and the lower barrier is not breached (or is breached but by a lesser degree than the upper barrier). For each quarter from 1 January 2006, the Spread payable is added to the spread for the previous quarter.			
Current Valuation and Rate Information The MtMs of the Swap as per the statements BST sent to MdL are set out below.			
MtM value of the swap on the Trade	The financial experts agree this to be in the range of -€9 million to –€15 million.	**MtM value on 1 October 2015**	- €25,726,621

[56] As at payment date immediately prior to 1 October 2015.

Date			
Interest rate payable on Pay leg on 1 October 2015	33.3046%	**Interest rate payable on Receive Leg on 1 October 2015**	Euribor 6M – 0.71% (-0.539%)
First date on which STCP failed to make payment under swap	1 October 2013	**First date lower barrier crossed**	19 December 2008
		First payment date lower barrier crossed while Spread active	1 April 2009

Second MdL Swap – Mark to Market Valuations

Date of MtM value	MtM / PV value[57]	Date of Statement
30/12/2005	€212,982	13/03/2008
31/12/2007	-€4,392,088	13/03/2008
29/12/2006	-€198,650	13/03/2008
30/05/2008	-€2,163,719	12/06/2008
30/09/2008	-€10,640,359	09/10/2008
31/12/2008	-€28,668,486	05/12/2008
30/06/2009	-€9,243,676	06/07/2009
30/09/2009	-€31,184,605	06/10/2009
30/06/2010	-€36,470,400	09/07/2010
30/09/2010	-€44,832,499	06/10/2010
30/07/2010	-€40,139,478	04/08/2010
31/12/2010	-€40,291,734	13/01/2011
29/10/2010	-€45,235,449	05/11/2010
30/11/2010	-€42,496,384	06/12/2010
31/01/2011	-€40,639,711	09/02/2011
31/03/2011	-€36,653,597	08/04/2011
29/07/2011	-€51,844,920	05/08/2011
30/09/2011	-€55,139,824	06/10/2011
30/12/2011	-€53,039,563	09/01/2012
30/03/2012	-€52,575,970	03/04/2012
29/06/2012	-€52,993,162	09/07/2012
31/10/2012	-€53,180,685	06/11/2012

[57] All figures rounded to the nearest Euro

28/09/2012	-€55,720,441	10/10/2012
31/12/2012	-€53,483,505	06/02/2013
28/03/2013	-€50,561,329	11/04/2013

THIRD MDL SWAP – KEY FACTS			
Basic Details			
Company type	*Entidade pública empresarial* (E.P.E)	**Trade date**	30 March 2006
Date of ISDA Master Agreement	31 July 2002 (signed on 23 November 2005)	**Effective date**	15 March 2006
Date of confirmation of MdL 3 Swap	30 March 2006 (signed around October 2006)	**Maturity period**	13.5 years
Amortisation profile	The notional amount amortised over the life of the Swap from €78.56 million to €2.91 million.	**Termination date**	16 September 2019
		Initial notional amount	€78,560,668.78
Underlying agreement details	Loan from the European Investment Bank for PTE 47,000,000 dated 28 October 1994	**Outstanding notional amount**	€26,186,890[58]
		Underlying agreement rate	Euribor 3M + 0.15% (originally 3M LISBOR + 0.15%)
Swap Terms			
Receive leg	BST pays MdL Euribor 3M, quarterly (on 15 March, 15 June, 15 September and 15 December) This coupon is calculated with reference to the amortising notional amount.	**Pay leg**	MdL pays BST a coupon quarterly (on 15 March, 15 June, 15 September and 15 December), as follows: (i) 15 March 2006 to, and including, 15 September 2008 - 2.75% plus Spread (ii) 15 September 2008 to, and including, 16 September 2019 - 3.12% plus Spread This coupon is calculated with reference to the amortising notional amount.
Spread	Previous Spread + Max (Euribor 3M IA – 6.75%, 0.00%) + Max (2.75% - EUR CMS10Y IA, 0.00%)	**Upfront payment**	None
		Other features	None
Explanation of the Spread: According to the Spread formula, the Spread is activated on the calculation date whenever the 10 year EURIBOR swap rate was below 2.75% or the 3M EURIBOR rate was above 6.75%. For each quarter from 15 March 2006, the Spread would be added to the Spread for the previous quarter.			
Current Valuation and Rate Information The MtMs of the Swap as per the statements BST sent to MdL are set out below.			
MtM value of the swap on the Trade Date	The financial experts agree this to be in the range of -€0.9 million to –€2.4 million.	**MtM value on 1 October 2015**	- €16,737,206

[58] As at payment date immediately prior to 1 October 2015.

Interest rate payable on Pay leg on 1 October 2015	20.905%	**Interest rate payable on Receive Leg on 1 October 2015**	Euribor 3M (-0.014%)
First date on which STCP failed to make payment under swap	16 September 2013	**First date lower barrier crossed**	12 August 2010
		First payment date lower barrier crossed while Spread active	15 September 2010

Third MdL Swap – Mark to Market Valuations

Date of MtM value	MtM / PV value[59]	Date of Statement
31/12/2007	€2,648,942	13/03/2008
30/05/2008	€2,627,211	12/06/2008
29/12/2006	-€927,529	13/03/2008
30/09/2008	-€607,248	09/10/2008
31/12/2008	-€8,896,364	05/12/2008
30/06/2009	-€7,859,984	06/07/2009
30/09/2009	-€8,608,689	06/10/2009
30/06/2010	-€9,776,523	09/07/2010
30/09/2010	-€14,067,833	06/10/2010
31/12/2010	-€7,526,316	13/01/2011
30/07/2010	-€8,354,346	04/08/2010
31/03/2011	-€4,648,342	08/04/2011
29/10/2010	-€10,921,650	05/11/2010
30/11/2010	-€9,983,840	06/12/2010
31/01/2011	-€7,146,516	09/02/2011
29/07/2011	-€6,837,543	05/08/2011
30/09/2011	-€13,259,860	06/10/2011
30/12/2011	-€14,123,250	09/01/2012
30/03/2012	-€13,518,671	03/04/2012
29/06/2012	-€18,117,913	09/07/2012
28/09/2012	-€20,989,672	10/10/2012

[59] All figures rounded to the nearest Euro

31/10/2012	-€20,327,347	06/11/2012
31/12/2012	-€22,783,117	06/02/2013
28/03/2013	-€21,180,212	11/04/2013

FOURTH MDL SWAP – KEY FACTS			
Basic Details			
Company type	*Entidade pública empresarial* (E.P.E)	**Trade date**	31 May 2007
Date of ISDA Master Agreement	31 July 2002 (signed on 23 November 2005)	**Effective date**	15 March 2007
Date of confirmation of MdL 4 Swap	30 May 2007 (signed around February 2008)	**Maturity period**	15.25 years
Amortisation profile	The notional amount fluctuates over the lifetime of the swap, from €4.28 million at inception, through €64.73 million at its highest point, to €8.31 million at termination.	**Termination date**	15 June 2022
		Initial notional amount	€4,280,558.63
Underlying agreement details	Restructured EIB Loan Agreement between MdL and EIB dated 10 March for €218,806,010.83	**Outstanding notional amount**	€50,588,042[60]
		Underlying agreement rate	3M Euribor + 0.673%
Swap Terms			
Receive leg	Euribor 3M quarterly (on 15 March, 15 June, 15 September and 15 December). This coupon is calculated with reference to the amortising notional amount.	**Pay leg**	MdL pays BST a coupon quarterly (on 15 March, 15 June, 15 September and 15 December), as follows: (i) 15 March 2007 to, and including, 15 March 2010 - 2% (ii) 15 June 2010 to, and including, 15 June 2022 - 1.65% plus Spread This coupon is calculated with reference to the amortising notional amount.
Spread	Max {0.00%; Previous spread +2.25 x [Max (Index – 6.00%, 0.00%) + Max (2.00% - Index, 0.00%] – Digicoupon} where "Index" is EURIBOR 3M observed in arrears.	**Upfront payment**	BST paid MdL a one off fixed amount of €7.725 million on 4 June 2007.
		Other features	The Digicoupon for the swap is 0.50% if 2.00% < Euribor 3M < 6.00% otherwise Digicoupon = 0%.
Explanation of the Spread: According to the Spread formula, the Spread is activated on the calculation date whenever the 3M EURIBOR rate was below 2% or above 6%. For each quarter from 15 March 2010, the Spread payable would be added to the Spread for the previous quarter. There is a multiplying factor of 2.25 on activation of the Spread. For example, if the reference rate has moved 1.00% outside of one of the barriers, following application of the multiplying factor the Spread would increase by 2.25%. Conversely, the swap includes a "Digicoupon" which operates to reduce any Spread which has accumulated by 0.5% if the 3M EURIBOR rate moves back within the range 2% - 6% on the relevant calculation date for that coupon payment. Note the Spread cannot be negative. For example, if the previous Spread is 0.30% and 3M EURIBOR on the calculation date is between 2% and 6%, implying a Digicoupon of 0.50%, then the Spread would be 0.00%.			
Current Valuation and Rate Information The MtMs of the Swap as per the statements BST sent to MdL are set out below.			

[60] As at payment date immediately prior to 1 October 2015.

MtM value of the swap on the Trade Date	Approximately -€9 million.	**MtM value on 1 October 2015**	- €429,088,856
Interest rate payable on Pay leg on 1 October 2015	71.229%	**Interest rate payable on Receive Leg on 1 October 2015**	Euribor 3M: (-0.014%)
First date on which STCP failed to make payment under swap	16 September 2013	**First date lower barrier crossed**	10 February 2009
		First payment date lower barrier crossed while Spread active	15 September 2010

Fourth MdL Swap – Mark to Market Valuations

Date of MtM value	MtM / PV value[61]	Date of Statement
31/12/2007	-€31,175,312	13/03/2008
30/05/2008	-€32,958,602	12/06/2008
30/09/2008	-€47,276,113	09/10/2008
31/12/2008	-€64,481,049	05/12/2008
30/06/2009	-€60,318,215	06/07/2009
30/09/2009	-€77,016,331	06/10/2009
30/06/2010	-€143,122,511	09/07/2010
30/09/2010	-€158,853,026	06/10/2010
31/12/2010	-€142,021,807	13/01/2011
30/07/2010	-€124,244,783	04/08/2010
31/03/2011	-€89,003,739	08/04/2011
29/10/2010	-€140,494,858	05/11/2010
30/11/2010	-€157,808,002	06/12/2010
31/01/2011	-€127,497,573	09/02/2011
29/07/2011	-€141,426,874	05/08/2011
30/09/2011	-€205,894,957	06/10/2011
30/12/2011	-€232,093,259	09/01/2012
30/03/2012	-€251,355,450	03/04/2012
29/06/2012	-€302,578,418	09/07/2012
28/09/2012	-€366,778,315	10/10/2012

[61] All figures rounded to the nearest Euro

31/10/2012	-€358,998,768	06/11/2012
31/12/2012	-€393,466,458	06/02/2013
28/03/2013	-€381,386,291	11/04/2013

<table>
<tr><th colspan="4">FIRST MDP SWAP – KEY FACTS</th></tr>
<tr><th colspan="4">Basic Details</th></tr>
<tr><td>Company type</td><td>Sociedade anónima (S.A.)</td><td>Trade date</td><td>11 January 2007</td></tr>
<tr><td>Date of ISDA Master Agreement</td><td>11 January 2007 (signed 21 May 2007)</td><td>Effective date</td><td>13 December 2006</td></tr>
<tr><td>Date of confirmation of Swap</td><td>11 January 2007 (signing date unknown)</td><td>Maturity period</td><td>16 years</td></tr>
<tr><td rowspan="2">Amortisation profile</td><td rowspan="2">Amortises from €89,083,544.79 on calculation period commencing 13 December 2006 to €50,095,861.88 on calculation period ending 13 December 2022 (this is consistent with the underlying BCP Swap and Nortrem Contract).</td><td>Termination date</td><td>13 December 2022</td></tr>
<tr><td>Initial notional amount</td><td>€89,083,544.79</td></tr>
<tr><td rowspan="2">Underlying agreements details</td><td rowspan="2">Train rental contract with Nortrem (Nortrem Contract) dated 13 December 2002 and BCP Swap dated 27 March 2003</td><td>Outstanding notional amount[62]</td><td>€69,303,194.05</td></tr>
<tr><td>Underlying agreement rate</td><td>Nortrem Contract links payments to 6M EURIBOR
BCP Swap swaps 6M EURIBOR for a fixed rate of 4.76%</td></tr>
<tr><th colspan="4">Swap Terms</th></tr>
<tr><td>Receive leg</td><td>BST pays 4.76% semi-annually (on 13 June and 13 December each year)</td><td>Pay leg</td><td>MdP pays BST:
(i) 1.76% semi-annually (on 13 June and 13 December each year); plus
(ii) Spread quarterly (on 13 March, 13 June, 13 September and 13 December). The Spread is set to zero for the payment dates from, and including, 13 March 2007 to, and including, 13 December 2008.</td></tr>
<tr><td>Spread</td><td>Max (0.00%, Previous Spread + 2 x Max (2.00% - 3M EURIBOR, 0.00%) + 2 x Max (3M EURIBOR – 6.00%, 0.00% - Digicoupon)</td><td>Other features</td><td>The Digicoupon for the swap is 0.50% if 2.00% < 3M EURIBOR < 6.00% otherwise Digicoupon = 0%</td></tr>
<tr><td colspan="4">Explanation of the Spread: According to the Spread formula, the Spread is activated on the calculation date whenever the 3M EURIBOR rate falls below 2% or rises above 6%. The Spread is set to zero for payment dates to, and including, 13 December 2008.

There is a multiplying factor of 2 on activation of the Spread. For example, if the reference rate has moved 1.00% outside of one of the barriers, following application of the multiplying factor the Spread would increase by 2.00%.

Conversely, the Swap includes a “Digicoupon” which operates to reduce any Spread which has accumulated by 0.5%, if the 3M EURIBOR rate moves back within the range 2% - 6% on the relevant calculation date for that coupon payment. Note the Spread cannot be negative. For example, if the Previous spread is 0.30% and 3M EURIBOR on the calculation date is between 2% and 6%, implying a Digicoupon of 0.50%, then the Spread would be 0.00%.</td></tr>
</table>

[62] As at payment date immediately prior to 1 October 2015.

Current Valuation and Rate Information The MtMs of the Swap as per the statements BST sent to MdP are set out below.			
MtM value of the swap on the Trade Date	Between -€11.6m and -€15.3m	**MtM value on 1 October 2015**	-€524,656,404
Interest rate payable on Pay leg on 1 October 2015	71.864%	**Interest rate payable on Receive Leg on 1 October 2015**	4.76%
First date on which MdP failed to make payment under the First MdP Swap	13 September 2013	**First date lower barrier crossed**	10 February 2009
		First payment date lower barrier crossed while Spread active	15 June 2009

First MdP Swap - Mark to Market Valuations

Date of MtM value	MtM / PV value[63]	Date of statement
30/05/2008	-30,840,916	11/06/2008
30/06/2008	-70,619,153	02/07/2008
31/07/2008	-52,907,446	06/08/2008
29/08/2008	-42,483,555	04/09/2008
30/09/2008	-48,572,055	07/10/2008
31/12/2009	-144,831,497	06/01/2010
30/09/2008	-272,696,223	06/10/2010
31/12/2010	-255,262,458	10/01/2011
31/05/2011	-217,335,268	06/06/2011
30/06/2011	-199,041,134	07/07/2011
31/08/2011	-294,186,230	05/09/2011
30/09/2011	-314,880,728	06/10/2011
30/11/2011	-317,766,649	05/12/2011
30/12/2011	-343,018,691	10/01/2012
31/01/2012	-375,746,889	08/02/2012
29/02/2012	-372,701,271	16/03/2012
30/03/2012	-361,471,713	11/04/2012
13/04/2012	-376,476,481	16/04/2012
20/04/2012	-365,898,319	23/04/2012
27/04/2012	-379,143,092	30/04/2012
30/04/2012	-389,479,009	07/05/2012
04/05/2012	-406,545,704	08/05/2012
11/05/2012	-406,037,645	15/05/2012
18/05/2012	-411,062,559	22/05/2012
25/05/2012	-437,151,468	31/05/2012
31/05/2012	-466,800,154	05/06/2012

[63] All figures rounded to the nearest Euro

01/06/2012	-470,212,137	06/06/2012
08/06/2012	-439,472,857	12/06/2012
22/06/2012	-419,973,440	28/06/2012
29/06/2012	-415,497,428	09/07/2012
06/07/2012	-444,753,720	12/07/2012
13/07/2012	-446,625,603	20/07/2012
20/07/2012	-468,535,382	30/07/2012
27/07/2012	-441,809,290	01/08/2012
14/09/2012	-453,655,547	17/09/2012
21/09/2012	-489,069,462	24/09/2012
28/09/2012	-477,589,818	10/10/2012
09/11/2012	-491,349,028	14/11/2012
21/12/2012	-494,775,044	27/11/2012
28/12/2012	-504,227,004	07/01/2013
28/02/2013	-483,826,570	07/03/2013
31/12/2012	-504,270,084	08/01/2013
05/04/2013	-503,210,949	24/04/2013

SECOND MDP SWAP – KEY FACTS			
Basic Details			
Company type	*Sociedade anónima* (S.A.)	**Trade date**	13 August 2007
Date of ISDA Master Agreement	11 January 2007 (signed 21 May 2007)	**Effective date**	17 September 2007
Date of confirmation of Swap	Undated (signed around April 2008)	**Maturity period**	20 years
Amortisation profile	Amortises from €60,000,000.00 on calculation period commencing 17 September 2007 to €30,750,000.00 on calculation period ending 15 September 2027 (this is consistent with the amortisation profile of the underlying Depfa Loan Agreement for which the notional of the Second MdP Swap accounts for 60%).	**Termination date**	15 September 2027
		Initial notional amount	€60,000,000.00
Underlying agreements details	Loan Agreement between Depfa ACS Banks as Lender and BSN as Joint Lead Arranger and Paying Agent dated 13 August 2007 for €100,000,000.00	**Outstanding notional amount**	€48,750,000[64]
		Underlying agreement rate	3M EURIBOR plus 0.50%
Swap Terms			
Receive leg	BST pays 3M EURIBOR quarterly (on 15 March, June, September and December)	**Pay leg**	MdP pays BST quarterly (on 15 March, June, September and December): (i) For the payment dates from 15 December 2007 to 15 September 2011 = 1.75%; and (ii) For the payment dates from and including 15 December 2011 until maturity = 1.75% plus Max (0.00%, Spread)
Spread	Previous Spread + 1.50 x Max (-0.20%, 3M EURIBOR IA, – 6.50%)	**Other features**	The swap contains a switch option provision in favour of BST: starting from 15 September 2011, and on every payment date up to, but not including the final payment date, BST has the option to switch MdP's payments to BST to 3M EURIBOR minus 1.50%
Explanation of the Spread: According to the Spread formula, the Spread increases on the calculation date whenever the 3M EURIBOR IA rate rises above 6.50%. The Spread is cumulative for payments from the calculation date 15 September 2011. There is a multiplying factor of 1.5 on the Spread accumulation. For example, if the reference rate (3M EURIBOR IA) has moved 1.00% outside the barrier (6.50%), following application of the multiplying factor the Spread would increase by 1.50%. The Swap includes a "cushion" which operates to reduce any Spread which has accumulated by 0.30% (i.e. 0.20% times the multiplying factor of 1.5), if the 3M EURIBOR IA rate is below 6.50% on the relevant calculation date for that coupon payment. The cushion can cause the Spread to become negative. For example, if the Previous spread is 0.00% and 3M EURIBOR IA on the calculation date is below 6.50%, implying a cushion			

[64] As at payment date immediately prior to 1 October 2015.

of 0.30%, then the Spread would be -0.30%. Note that a negative Spread does not affect payments under the fixed portion of the coupon (which is always 1.75%), as the Spread is only payable if positive.			
Current Valuation and Rate Information The MtMs of the Swap as per the statements BST sent to MdP are set out below.			
MtM value of the swap on the Trade Date	Between -€6m and -€10m	**MtM value on 1 October 2015**	-€6,126,374
Interest rate payable on Pay leg on 1 October 2015	1.75%	**Interest rate payable on Receive Leg on 1 October 2015**	3M EURIBOR (-0.014%)
First date on which MdP failed to make payment under the Second MdP Swap	16 September 2013	**First date lower barrier crossed**	N/A
		First payment date lower barrier crossed while Spread active	N/A

Second MdP Swap - Mark to Market Valuations

Date of MtM value	MtM / PV value[65]	Date of statement
30/05/2008	-7,560,256	11/06/2008
30/06/2008	-13,477,338	02/07/2008
31/07/2008	-13,999,127	06/08/2008
29/08/2008	-10,001,752	04/09/2008
30/09/2008	-9,897,311	07/10/2008
31/12/2009	-21,156,724	06/01/2010
30/09/2008	-14,286,221	06/10/2010
31/12/2010	-27,540,956	10/01/2011
31/05/2011	-21,078,078	08/06/2011
30/06/2011	-16,812,978	07/07/2011
31/08/2011	-18,533,160	05/09/2011
30/09/2011	-16,477,071	06/10/2011
30/11/2011	-18,488,300	05/12/2011
30/12/2011	-17,636,805	10/01/2012
31/01/2012	-14,452,257	08/02/2012
29/02/2012	-18,880,786	16/03/2012
30/03/2012	-10,789,674	11/04/2012
13/04/2012	-12,315,974	16/04/2012
20/04/2012	-14,040,095	23/04/2012
27/04/2012	-14,736,687	30/04/2012
30/04/2012	-12,547,246	07/05/2012
04/05/2012	-14,547,227	08/05/2012
11/05/2012	-17,685,213	15/05/2012
18/05/2012	-20,379,422	22/05/2012
25/05/2012	-16,858,635	31/05/2012

[65] All figures rounded to the nearest Euro

31/05/2012	-15,708,216	05/06/2012
01/06/2012	-16,705,287	06/06/2012
08/06/2012	-15,523,545	12/06/2012
22/06/2012	-11,969,052	28/06/2012
29/06/2012	-11,132,079	09/07/2012
06/07/2012	-10,385,968	12/07/2012
13/07/2012	-15,067,600	20/07/2012
20/07/2012	-8,894,572	30/07/2012
27/07/2012	-12,190,334	01/08/2012
14/09/2012	-8,529,933	17/09/2012
21/09/2012	-8,742,056	24/09/2012
28/09/2012	-7,419,700	10/10/2012
09/11/2012	-3,701,975	14/11/2012
21/12/2012	-2,335,737	27/11/2012
28/12/2012	-2,240,533	07/01/2013
28/02/2013	-2,514,408	07/03/2013
31/12/2012	-2,250,148	08/01/2013
05/04/2013	-12,774,547	24/04/2013

STCP SWAP – KEY FACTS			
Basic Details			
Company type	*Sociedade anónima* (S.A.)	**Trade date**	2 November 2007
Date of ISDA Master Agreement	2 November 2007 (signed on 20 May 2008)	**Effective date**	5 December 2007
Date of confirmation of STCP Swap	2 November 2007 (signed around May 2008)	**Maturity period**	14.5 years
Amortisation profile	No amortisation – remains constant at €25,000,000.00 for the life of the swap (this is consistent with the amortisation profile of the underlying bond).	**Termination date**	5 June 2022
		Initial notional amount	€25,000,000.00
Underlying agreement details	Issuance of bonds by STCP to the value of €100,000,000 dated 5 June 2007	**Outstanding notional amount**	€25,000,000.00[66]
		Underlying agreement rate	6M EURIBOR + 0.0069%
Swap Terms			
Receive leg	BST pays STCP 6M EURIBOR semi-annually (on 5 June and 5 December each year)	**Pay leg**	STCP pays BST a coupon semi-annually (on 5 June and 5 December each year): (i) For the calculation dates[67] from 5 December 2007 to 5 December 2010 = 2.23%; and (ii) For the calculation dates from 5 March 2011 until maturity = 2.23% plus Spread.
Spread	Max (0.00%, Previous spread + 1.25x Max (0.00%, 2.00% - 3M EURIBOR) + 1.25 x Max (3M EURIBOR – 6%; 0.00%) – Digicoupon)	**Other features**	The Digicoupon for the swap is 0.50% if 2.00% < 3M EURIBOR < 6.00% otherwise Digicoupon = 0%.
Explanation of the Spread: According to the Spread formula, the Spread is activated on the calculation date whenever the 3M EURIBOR rate falls below 2% or rises above 6%. The Spread is cumulative for payments from the calculation date 5 March 2011. There is a multiplying factor of 1.25 on activation of the Spread. For example, if the reference rate has moved 1.00% outside of one of the barriers, following application of the multiplying factor the Spread would be 1.25%. Conversely, the Swap includes a "Digicoupon" which operates to reduce any Spread which has accumulated by 0.5%, if the 3M EURIBOR rate moves back within the range 2% - 6% on the relevant calculation date for that coupon payment. Note the Spread cannot be negative. For example, if the Previous spread is 0.30% and 3M EURIBOR on the calculation date is between 2% and 6%, implying a Digicoupon of 0.50%, then the Spread would be 0.00%.			
Current Valuation and Rate Information The MtMs of the Swap as per the statements BST sent to STCP are set out below.			
MtM value of the swap on the Trade Date	Approximately -€1,500,000 **[D2/59]**	**MtM value on 1 October 2015**	- €120,013,720
Interest rate payable on Pay leg on 1 October 2015	36.743%	**Interest rate payable on Receive Leg on 1 October 2015**	6M EURIBOR (0.176%)

[66] As at payment date immediately prior to 1 October 2015.
[67] Referred to in the swap confirmation as the "Floating Coupon Calculation End Dates"

First date on which STCP failed to make payment under swap	5 December 2013	**First date lower barrier crossed**	10 February 2009
		First payment date lower barrier crossed while Spread active	16 June 2011 (associated with the calculation period ending 7 March 2011)

STCP Swap - Mark to Market Valuations

Date of MtM value	MtM / PV value[68]	Date of statement
30/04/2008	-€3,304,339	07/05/2008
30/05/2008	-€4,744,643	04/06/2008
30/06/2008	-€10,010,254	02/07/2008
29/08/2008	-€7,006,076	04/09/2008
31/08/2008	-€8,681,409	06/08/2008
30/09/2008	-€7,019,472	07/10/2008
31/10/2008	-€4,965,467	04/11/2008
28/11/2008	-€8,150,036	05/12/2008
31/12/2008	-€14,696,800	05/01/2009
30/01/2009	-€12,160,512	09/02/2009
30/06/2009	-€11,235,720	06/07/2009
31/08/2009	-€16,994,020	04/09/2009
30/10/2009	-€16,848,257	04/11/2009
30/11/2009	-€18,147,446	04/12/2009
31/12/2009	-€15,966,873	07/01/2010
29/01/2010	-€17,430,144	05/02/2010
26/02/2010	-€17,681,326	08/03/2010
31/03/2010	-€17,897,432	08/04/2010
30/04/2010	-€21,934,342	06/05/2010
31/05/2010	-€32,037,511	07/06/2010
30/06/2010	-€33,277,532	05/07/2010
30/09/2010	-€45,913,498	06/10/2010
29/10/2010	-€34,966,269	05/11/2010
30/11/2010	-€40,551,555	09/12/2010
31/12/2010	-€33,955,531	10/01/2011
31/01/2011	-€31,585,041	03/02/2011
31/03/2011	-€20,645,410	08/04/2011
29/04/2011	-€21,153,885	04/05/2011
30/06/2011	-€25,418,695	06/07/2011
31/10/2011	-€55,185,585	03/11/2011
30/11/2011	-€49,124,237	05/12/2011
30/12/2011	-€62,230,602	12/01/2012
31/01/2012	-€68,623,721	06/02/2012
29/02/2012	-€68,901,503	09/03/2012
30/03/2012	-€67,478,089	03/04/2012

[68] All figures rounded to nearest Euro

30/04/2012	-€74,891,997	07/05/2012
29/06/2012	-€81,795,424	09/07/2012
31/07/2012	-€93,649,794	06/08/2012
30/11/2012	-€97,868,513	05/12/2012
31/12/2012	-€101,433,437	09/01/2013
31/01/2013	-€84,364,346	08/02/2013
28/02/2013	-€96,178,183	07/03/2013
28/03/2013	-€99,192,390	11/04/2013
30/04/2013	-€107,618,053	10/05/2013
31/12/2013	-€95,069,619	