

Financial Services Client Service Group

To: Our Clients and Friends

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Derivatives

English law: ultra vires and the ISDA Master Agreement – counterparty’s warranty as to capacity saves the day for Credit Suisse International ("CSI")

It is a principle of English law that a contract which is ultra vires one of the parties is treated as if it never existed. Nor is a representation given by that party, that such a contract is valid and binding, effective to give the other party to the contract any rights in respect of it - if it is beyond the capacity of a party to enter into a particular contract then no representation by such party as to its validity can save it or otherwise confer rights.

However the English High Court in *Credit Suisse International v Stichting Vestia Groep* [2014] EWHC 3103 (Comm) found a way round this obstacle to CSI's contractual claim. Although the judge (Mr Justice Andrew Smith) held that consistent with the above principle the relevant representations in Section 3 of the ISDA Master Agreement were not effective in the case of ultra vires Transactions, he decided that similar provisions in the “Additional Representations” that had been inserted in the Schedule to the Master Agreement during the original negotiations were not just representations but were also contractual warranties and undertakings. As such, they were effective to catch future Transactions whether or not ultra vires.

Background

Stichting Vestia Groep (“Vestia”) is a Dutch social housing association. It is a private entity, not a public body such a municipality. Had it been an English company, the issue of ultra vires would not have been relevant as a result of sections 39 and 40 of the Companies Act 2006. However, it was accepted by the court that those sections did not apply here. Vestia entered into 11 trades with CSI over a period of 10 months under a 2002 ISDA Master Agreement which was expressed to be governed by English law - the trades comprised 5 plain vanilla interest rate swaps, 3 swaptions, 2 constant maturity swaps and what was referred to as a callable range accrual swap. As a separate issue, the court held that those trades should be grouped into 7 Transactions or contracts, of which the court went on to hold that 3 Transactions were (as a matter of Dutch law) ultra vires Vestia. It is beyond this Bulletin to discuss the reasoning of the court on this aspect of the case save to say

that the result was that all of the trades making up the 3 ultra vires Transactions were therefore held to be void. CSI had terminated the Master Agreement (after Vestia had failed to meet a collateral call) and claimed the Early Termination Amount (approximately EUR 83,000,000). A key part of Vestia's defence to CSI's contractual claim was that the majority of the trades were never binding on Vestia because they were ultra vires.

The 2002 ISDA Master Agreement

Relevant for CSI's purposes were:

- representations made by Vestia under Section 3 of the Master Agreement both on its execution and deemed to be repeated whenever a Transaction was entered into. These included representations as to its power to enter into the Master Agreement and any document relating to the Master Agreement, no conflict with its constitutional documents and the legal, valid, binding and enforceable nature of its obligations.
- similar representations given in a "Management Certificate" by Vestia (pursuant to Section 3(d)) on entering into the Master Agreement.
- "Additional Representations" set out in the Schedule to the Master Agreement (contemplated in Section 3 of the Master Agreement) - including that Vestia "represents and warrants" that its "entry into and performance of its obligations under this Agreement and each Transaction hereunder is and will be in compliance with" its constitutional documents.

The court's decision on CSI's claim

CSI had during the negotiations insisted on the inclusion of the "Additional Representations", saying they were market standard. This proved to be key. The court held that these "Additional Representations" in fact were not just representations, notwithstanding they were called "Additional Representations". That label, and that Section 3 is headed "Representations", was not relevant since the Master Agreement expressly stated that headings should not be used in construing the provisions of the Master Agreement (see Section 9(g)). The court went on to say that in its view the parties in fact intended that the "Additional Representations" be warranties and undertakings as well as representations. That is, that the "Additional Representations" were also undertakings as to future conduct - in effect that Vestia would only enter into Transactions which were within its powers and capacity. Since the Master Agreement itself was not ultra vires (it was accepted that Vestia had capacity to enter the Master Agreement), just the 3 Transactions, these warranties and undertakings were effective. Accordingly by entering into Transactions that were ultra vires Vestia and beyond the powers of its directors, Vestia was in breach of these warranties and undertakings. Vestia was contractually estopped from asserting that the Transactions were ultra vires. CSI could therefore succeed in its claim for the Early Termination Amount.

In the words of the judge: "... there seems to me no reason that [a party] should not in a valid contract [in this case the Master Agreement] undertake that the contract will not be used as a vehicle for purported transactions that are invalid because they are outside their capacity. Credit Suisse are not making a claim under the ultra vires contracts...and are not asserting that they are valid. Their argument is that they are entitled to enforce the Master Agreement as if the ultra vires

contracts were valid...[In the view of the judge] it is not open to Vestia to dispute their liability to Credit Suisse under the Master Agreement on the grounds that the ultra vires contracts were outside their capacity and so invalid.”

Comment

The fine distinction between a mere representation (a statement as to present fact) and a warranty (a contractual undertaking as to future conduct) was one that proved to be fatal for Vestia and the basis on which CSI was entitled to the Early Termination Amount. Banks and their legal advisers will take note whenever there is a concern about the capacity of their counterparties.

There are several other decisions in this case worthy of note but this aspect of the case is likely to be the decision of broadest interest. In a [separate Bulletin](#) we look at why the court came to the view that some of the Transactions comprised more than one trade.

For more information on this subject, kindly send your questions to one of the below, your contact at Bryan Cave or to any member of the [Financial Services Client Service Group](#).

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