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Banking & Finance Litigation
Switzerland

Client Alert
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Baker McKenzie obtains a landmark judgment favoring lenders in relation to negative interest

What's the decision about?

The Swiss Federal Supreme Court rendered a landmark decision on negative interest in loan agreements, which it will publish in its Official Collection of Judgments.[1] For the very first time, the Court held that, unless the parties have agreed otherwise, the obligation to pay interest under a loan agreement shall not be shifted to the lender. In an *obiter dictum*, the Court also considered that, in certain cases, the bank might be entitled to claim the whole margin even if LIBOR becomes negative. Baker McKenzie successfully represented the bank in these proceedings.

Relevant facts

In 2012, the bank acquired a CHF 50 million loan, which was granted to the borrower in 2006 based on a certificate evidencing indebtedness (*Schuldschein*). The loan was governed by Swiss law and had a term of 20 years. The agreement provided for an interest rate equal to CHF 6 months' LIBOR plus a margin of 0.0375% per annum. When the total interest (i.e., LIBOR plus margin) became negative, the borrower sued the bank for the payment of negative interest. The courts of first and second instance of the Canton of Geneva dismissed the suit.

The Court's reasoning

The Court started by stating that the parties of a loan agreement are free to agree that the repayment amount is less than the loan amount, be it based on a lender's loss participation or otherwise. The Court therefore held that the parties are also free to expressly provide for the payment of negative interest by the lender to the borrower. Such contract should be qualified as an atypical loan agreement or an innominate contract.

The question of how a negative benchmark rate affects the interest rate payable must be answered by an interpretation of the loan agreement. If the real intention of the parties cannot be established or if the parties' intentions diverge, the agreement must be interpreted objectively.

The Court then recalled that Swiss doctrine provides for three different theories of how to address the consequences of negative interest rates. The first theory claims that the total interest rate payable can never be lower than the agreed margin, i.e., the borrower must at least pay the margin. The second theory

[1] Decision 4A_596/2018, dated 7 May 2019 (https://www.bger.ch/ext/eurospider/live/fr/php/aza/http/index.php?highlight_docid=aza%3A%2F%2Faza://07-05-2019-4A_596-2018&lang=fr&zoom=&type=show_document).

argues that the total interest rate cannot fall below zero, i.e., the lender must never pay interest to the borrower. Only the third theory suggests that the total interest rate can be negative, i.e., that the lender must pay interest to the borrower. This third theory is argued to apply particularly when a negative total interest rate and a refinancing at a negative interest rate were foreseeable for the parties at the time of concluding the contract.

The Court did not favor one theory over the other. Rather, it held that the formulaic computation of the interest rate could not be interpreted as meaning that the bank had implicitly agreed to pay negative interest to its customer. Indeed, not only was the contract silent in this respect, but several standard provisions actually provided for the payment of interest by the borrower. Furthermore, even if the parties could foresee at the time of concluding the contract that the CHF LIBOR may fluctuate, they could — more than eight years before the Swiss National Bank introduced a negative interest rate in January 2015 — neither envisage a reversal of the obligation to pay interest nor foresee that the bank could refinance itself at negative rates, although negative interests were not unknown at that time. The 20-year term of the loan and, thus, the likelihood that the (positive) interest received by the bank over the entire term of the contract would be higher than the (negative) interest possibly paid by the bank, was not decisive either according to the Court, because the contract expressly provided for interest periods of six months.

Regarding the possibility for the bank to claim its margin notwithstanding the total interest rate being negative, the Court admitted that this could theoretically be possible. However, in commercial transactions, the loan agreement is supposed to be onerous, i.e., to bear interest. A cancellation of the margin may be seen as conflicting with the onerous character of the loan agreement, especially in cases (such as this one) in which the contract was concluded at a time when the parties could not (or not easily) foresee that the margin could potentially be affected by a shifting of the benchmark rate into the negative. However, the Court left this issue open as the bank had decided not to claim the payment of its margin in the proceedings.

What are the main takeaways?

This decision is particularly relevant for loan agreements concluded before the Swiss National Bank introduced negative interest rates in January 2015. For such contracts, the risks of a lender being ordered to pay negative interest to a borrower under Swiss law are low. A lender could even try to claim for payment of the margin, with fair chances of success.

The risks in relation to contracts concluded after 2015 are obviously higher. Indeed, it will be difficult for a lender to argue that it could not envisage a shifting of the interest rate into the negative. A court could hold that the lender should have addressed such a scenario explicitly in the contract. This is what most banks do in younger loan agreements.

www.bakermckenzie.com

Baker McKenzie Geneva
Rue Pedro-Meylan 5
Geneva 1208
Switzerland
Tel: +41 22 707 9800
Luca Beffa
Jingjin Guo

Baker McKenzie Zurich
Holbeinstrasse 30
8034 Zürich
Switzerland
Tel: +41 44 384 14 14
Lukas Glanzmann,
Samuel Marbacher