Neutral Citation Number: [2022] EWHC 2586 (Comm)

Case No: FL-2019-000012

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS (ENGLAND AND WALES)
KING'S BENCH DIVISION
COMMERCIAL COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 14 October 2022

Before :

MR JUSTICE FOXTON

- -

Between :

(1) BANCA INTESA SANPAOLO SPA **(2) DEXIA CREDIOP SA**	**Claimants**
- and -	
COMUNE DI VENEZIA	**Defendant**

- -
- -

JASBIR DHILLON KC, **FRED HOBSON** and **TOM WOOD** (instructed by **Pinsent Masons LLP**) for the **Claimants**
RAYMOND COX KC, SIMON PAUL and **MARCUS FIELD** (instructed by **Osborne Clarke LLP**) for the **Defendant**

Hearing dates: 23, 27-30 June, 4-7, 11-14 and 19-21 July 2022
Further written submissions: 9, 15 and 21 September 2022
Draft judgment to parties: 3 October 2022

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Approved Judgment

I direct that no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

....

THE HONOURABLE MR JUSTICE FOXTON

This judgment was handed down by the judge remotely by circulation to the parties' representatives by email and release to The National Archives. The date and time for hand-down is deemed to be Friday 14 October 2022 at 10:00am.

Mr Justice Foxton :

A INTRODUCTION

1. In this case:

    i) The Claimants (**the Banks** which expression, as the context requires, also extends to the Claimants' predecessors in title) seek declarations that certain interest rate swap (**IRS**) transactions (**the Transactions**) which they say they entered into with the Defendant (**Venice**) on the terms of the 1992 ISDA Master Agreement are valid and binding, and alternative relief in contract and tort if it is found they are not.

    ii) Venice seeks declarations that the Transactions are not valid and binding (and consequential relief in unjust enrichment), and alternatively relief in contract and tort if it is found that they are.

2. Behind that simple symmetry lurks a complex set of questions raising disputes of pure fact, and of Italian and English law, some of them with potentially profound implications for the sanctity of English law contracts. By way of a very short introduction to those issues:

    i) Venice contends that, for various reasons, it lacked the substantive power to enter into the Transactions as a matter of Italian law, and that, applying English conflict of law principles, that means that it did not have capacity to enter into the Transactions and that they are not valid.

    ii) The Banks deny that the entry into the Transactions contravened any provisions of Italian law, on the basis of arguments as to the effect of Italian law and its application to the facts of this case, and further deny that any such contravention would deprive Venice of capacity to contract as a matter of English conflict of laws principles in any event.

    iii) Venice also contends that the Transactions breached various rules of Italian law which have the status of "mandatory rules of law" for the purposes of Article 3(3) of the European Union Convention 80/934/EEC (**the Rome Convention**) and that as a result the Transactions are void and/or unenforceable.

    iv) On this basis, Venice claims restitution of the net amounts paid under the Transactions to date. The Banks contend that they have a defence of change of position to these claims, and that Venice's claims are time-barred.

    v) If the Transactions are valid and binding, Venice alleges that the Banks owed Venice a non-contractual advisory duty to assess the suitability of the Transactions, which was breached, and that Venice has suffered loss as a result.

    vi) If the Transactions are not valid and binding, the Banks allege that Venice was in breach of various contractual duties or is liable to it in respect of various misrepresentations and/or misstatements, for which they claim damages.

B THE EVIDENCE

3. There was evidence from six witnesses of fact.

4. For the Banks, I heard evidence from:

   i) Mr Samir Belarbi, who at the relevant time was Head of the Debt Management Desk in the Seecond Claimant's (**Dexia's**) Public Finance Division in Italy;

   ii) Mr Carlo Gabbi, who at the relevant time was Head of Local Authorities in the Debt Capital Markets Division in the Investment Banking Team at Banca IMI, which formed part of the Intesa Sanpaolo Group; and

   iii) Mr Marino Binetti, who at the relevant time worked for Banca Intesa Infrastrutture e Sviluppo S.p.A. (**BIIS**) as a relationship manager for the region of Northeastern Italy (which included Venice).

5. For Venice, I heard evidence from:

   i) Mr Piero Dei Rossi, who was the Director of Venice's Finance Department between 2000 and 2017; and

   ii) Ms Gabriella Mutti, who from 1999 to 2017 was the officer in charge of the Venice Loan and Mortgage Office and reported to Mr Dei Rossi.

   Venice also put into evidence a statement from Mr Enzo Faro, who at the relevant time was a senior consultant at Brady Italia SRL (**Brady Italia**). This evidence was not challenged by the Bank.

6. I am satisfied that the factual witnesses were generally doing the best they could to assist the court, although I felt that Mr Binetti's evidence, when confronted with emails showing that the Transactions had been priced in part to recover the First Claimant's (**Intesa's**) contribution to the "Friends of Venice" fund, involved an attempt to distance himself from any involvement in or admitted recollection of an embarrassing subject (see [15] below). All of the factual witnesses faced the great difficulty of being questioned about events which had taken place, in the main, in and before 2007, some 15 years on. The need to reconstruct matters which they could no longer recollect, and to do so in the context of litigation in which the parties held strongly adversarial positions in a dispute with significant implications for both of them, inevitably influenced the reliability of the witness evidence. As is frequently the case, the evidential value of contemporaneous documentation and the inherent probabilities was significantly greater than the witnesses' oral evidence. That is as true of helpful answers drawn from a compliant witness under skilful cross-examination as it is of answers which support the case of the party who called the witness.

7. I heard expert evidence in three disciplines.

8. First expert evidence on Italian administrative/public law from:

   i) Professor Torchia, a Professor of Administrative Law at the University of Study of Rome "Roma Tre", called by the Banks; and

   ii) Professor Domenichelli, who was formerly a President of Administrative Law at the University of Padua, called by Venice.

9. Second, expert evidence on Italian civil law from:

    i) Professor Gentili, Emeritus Professor of Civil Law at Università Roma, called by the Banks; and

    ii) Professor Sciarrone Alibrandi, a Professor of Banking Law and Financial Markets Law at the Università Cattolica del Sacro Cuore, called by Venice.

10. The Banks submitted that both of Venice's Italian law experts were "unsatisfactory", suggesting that:

    i) Professor Alibrandi had a tendency to give "lengthy and discursive answers which failed to engage with the questions", provided answers which went beyond the questions asked and failed "scrupulously to maintain her independence", adopting "the role of an advocate for Venice";

    ii) Professor Domenichelli was reluctant to give direct answers to straightforward questions and tended to add "non-responsive" elaboration, and the court could not be confident that he "fully understood his duty to maintain his independence rather than adopt a partisan approach".

11. In my view, those criticisms are not made out:

    i) As a preliminary matter, they do not make appropriate allowance for the difficulties of experts being cross-examined on highly technical subjects through the intermediation of translation, with the attendant possibility of the intended meaning being lost at both stages of the translation exercise.

    ii) I accept that (as with many expert academics addressing their own discipline) there were occasions when Professor Alibrandi gave longer answers than the process of cross-examination in a tightly time-tabled trial can allow for. This was exacerbated by a tendency for the questions put to her to "parse" topics into smaller elements, which Professor Alibrandi did not regard as informative in isolation. However, she responded to the court's request that she seek to give shorter answers whenever possible. I am satisfied that in answering questions in the way in which she initially did, Professor Alibrandi was not seeking to avoid answering the questions or to be unhelpful – indeed quite the opposite.

    iii) Further, there was something of a clash of "the two cultures" when Mr Dhillon KC sought to test the evidence of both Venice's Italian law experts by reference to its implications for the practicalities of entering into swap transactions or the security of such transactions, considerations which those experts did not regard as relevant to the issues they had been asked to address or within their expertise.

    iv) I do not accept that any of the experts (on either side) deliberately sought to withhold what they believed to be relevant materials from the court.

    v) The reality is, as I explain below, that the Italian Supreme Court has expressed views which would involve a fundamental restatement of a number of the issues of Italian law debated in this case. Many respectable Italian scholars approve of that development (as is clear from some of the commentaries placed before the

court), and in any event are prepared to treat that reformulation as the best statement of Italian law as it now stands. Professors Alibrandi and Domenichelli are among their number. Others (including Professors Torchia and Gentili) do not share that view, believing that the Supreme Court has sought to derive legal doctrines from legislative sources which those instruments cannot support, and has interpreted other court decisions in ways they do not regard as tenable.

vi) That difference in view, and the reasons for it, were always going to give rise to fundamentally different approaches by the experts to the issues of Italian law in this case: Professors Alibrandi and Domenichelli inevitably sought to rely on the (significant volume of) recent court decisions which have tended to favour Venice's arguments, and Professors Torchia and Gentili to emphasise the legislative provisions and administrative decrees whose meanings, in their view, have been distorted or misunderstood by those recent decisions.

vii) That does not make the evidence of any expert partisan. I am fully satisfied that the views expressed by Professors Alibrandi and Domenichelli (like those of Professors Torchia and Gentili), be they right or wrong, are genuinely held, and fall within the spectrum of legitimate academic opinion on these difficult topics.

12. Both parties added additional Italian law authorities to the trial bundle in the period after the experts' reports were filed, and in Venice's case after expert cross-examination had been completed. I am satisfied that I am entitled to have regard to these decisions, not for any cogency in their reasoning, but as an indication of how in practice the *Cattolica* case (see [73] below) is currently being applied by Italian courts (the issues of principle having been fully ventilated with the experts).

13. Finally, I heard expert evidence on IRS transactions from:

i) Mr Pawan Malik of Delphinus Advisory (and formerly Global Head of Derivative Counterparty Risk Management Solutions with Barclays Capital), called by the Banks; and

ii) Ms Jackie Bowie of Chatham Financial, an expert advisory service for clients seeking to enter into IRS transactions, called by Venice.

14. As I explain at [219]-[221] below, I was not assisted by the IRS experts' views on whether or not the Transactions were speculative (and, in fairness to Mr Malik and the Banks, that has been their position throughout, including when seeking to resist permission for this evidence). In relation to the financial evaluation of the Transactions, there was limited dispute between the experts, and I found the evidence of both of them of assistance.

15. On the issue of the reasonableness of the pricing of the Transactions, I accept Mr Malik's evidence that the price was within the range of reasonable prices on offer at the time of trade, given his greater experience of derivative trading in the international swaps market at the relevant time as compared to Ms Bowie. I have reached that conclusion even though I accept that the Banks' margin had been formulated in part to cover the cost of the contribution which Intesa had agreed to make to the 'Amici di Venezia' or 'Friends of Venice' fund. That emerges clearly from Mr D'Aversa's emails of 14 May and 13 December 2007, Mr Binetti's emails of 18 October and 20 December

2007 and Mr Schiaroli of Banca Opi's email of 30 October 2007 (Banca Opi being Intesa's predecessor in title as explained at [18] below). I suspect that factor moved Dexia's profit, in particular, to the upper end of the reasonable range, because it was not making any such contribution but benefited from the terms intended to recover the contribution which Intesa was making. However, it must be kept in mind that the Banks' offering was chosen after a competitive tender process in which a number of banks participated.

16. The Banks also submitted that Ms Bowie's evidence was "unimpressive and unsatisfactory" in a number of respects and that her evidence bore "the hallmarks of a partisan witness" (with the result that, from the Banks' perspective, Venice had been singularly unfortunate or ill-advised in calling three experts, none of whom properly understood or adhered to their duty of independence). Once again, I am satisfied that this particular criticism was not fair. However, I accept that aspects of Ms Bowie's evidence on the question of whether the Transactions were speculative were difficult to follow or counter-intuitive, which reflected a combination of the inherent unsuitability of that topic for expert evidence, and the fact that certain of the contentions Ms Bowie put forward appeared to have been formulated for the first time in the course of cross-examination.

C THE FACTS

17. The parties were able to agree a factual narrative which covered most of the background facts, leaving a relatively limited area of factual dispute. This section of the judgment draws very heavily on that factual narrative, for which the court is very grateful. It then sets out my findings on the limited disputes of fact which arise.

The Parties

18. Intesa and Dexia are Italian companies carrying on business as banks. Intesa is a company within the Intesa Sanpaolo Group of companies, which has also includes Banca per la Finanza alle Opere Pubbliche e alle Infrastrutture S.p.A (**Banca Opi**) and BIIS. Intesa is the successor in title of Banca Opi.

19. At all material times, the Banks were authorised and regulated by the Bank of Italy and were 'authorised intermediaries' within the terms of Italian Legislative Decree No. 58 of 24 February 1998 and CONSOB Regulation No. 16190 of 29 October 2007 (which entered into force on 2 November 2007).

20. Venice is an Italian municipal authority.

The Governance Structure of Venice

21. The governance of Venice is exercised by:

    i) The City Council of Venice (**the City Council**). The City Council is the democratically elected body of the municipality. I accept Professor Torchia's evidence that the City Council's function was to set policy, but that it was not an executive body.

ii) The executive body (**the City Board**) comprised of the senior civil servants (**the Directors**) who were responsible for implementing policy as determined by the City Council. The key Director in this case was the Director of the Finance Department, Mr Dei Rossi.

The Rialto Bond and the Bear Stearns IRS

22. On 25 November 2002, the City Council of Venice passed City Council Resolution no. 194 (**Resolution 194**) pursuant to which the City Council resolved, amongst other things:

> "b. to authorise the issue of one or more bond loans for a total of total of €156,082,620.00, including placement commissions, for the reasons indicated in the introduction, and the features and terms of which are set out in Annex A to this resolution and form an integral and substantial part thereof, thus also authorising swap transactions where necessary and appropriate to hedge any interest rate fluctuations …
>
> d. to delegate to the Central Finance and Budget Directorate the drafting of all the acts resulting from this resolution and the negotiation and signing of the relevant transactions and contractual documentation."

23. The bond to be issued became known as **the Rialto Bond**.

24. On 20 December 2002, Venice agreed to an IRS transaction with Bear Stearns Bank plc (**Bear Stearns**) in connection with the obligations which Venice was to assume under the Rialto Bond (**the Bear Stearns IRS**). The terms of the Bear Stearns IRS, as originally entered into, included the following:

    i) The notional value was equal to €156,082,000 (i.e., the amount of the Rialto Bond) for the initial Calculation Period, and then reducing in accordance with the table at Appendix 1 of the confirmation.

    ii) The maturity date was 23 December 2005, with interest payable in June and December each year.

    iii) Venice would receive from Bear Stearns the 6-month EURIBOR variable rate plus 17 basis points (0.17%).

    iv) Venice would pay Bear Stearns the USD-LIBOR-BBA variable rate plus 95 basis points (0.95%), with a cap at 5.55% and a floor at 1.3%.

25. On 23 December 2002, Venice issued the Rialto Bond, which comprised 20-year floating rate bond notes, under which the principal amount due was €156,082,000. The notes were due to mature on 23 December 2022, bearing interest from and including 23 December 2002 at EURIBOR plus 0.17% payable semi-annually in arrears on each interest payment date.

26. An Executive Resolution no. 185 (signed by the Director of Venice's Finance Department, Mr Dei Rossi) approved the terms of the Bear Stearns IRS.

27. The Bear Stearns IRS was subsequently amended. On 17 April 2003, a further fixed income derivatives confirmation was issued under the Bear Stearns Master Agreement which had the same terms as the original Bear Stearns IRS save that it extended the Bear Stearns IRS termination date until 23 December 2006 and amended the floor rate payable by Venice to between 1% and 1.25% (depending on the period). Executive Resolution no. 1126, signed by Venice's Finance Director (Mr Dei Rossi) approved the terms of the amendment.

28. On 6 August 2004, the Bear Stearns IRS was further amended by a fixed income derivatives confirmation with an Effective Date of 23 June 2004 which reduced the nominal amount to EUR 148,089,040.78 for the Initial Calculation Period and then in accordance with a Schedule of Notional Amounts attached to the confirmation. This confirmation also extended the termination date of the Bear Stearns IRS until 23 December 2022 and amended the variable rate payable by Venice to:

    i) for the period from 23 June 2004 until 23 December 2006, 6-month EURIBOR minus 5 basis points, with a cap of 6% and a floor of between 2.1% and 2.5%;

    ii) from 23 December 2006 until 23 December 2022, 6-month EURIBOR with a variable spread falling from 1.50620% to -0.1997%, subject to a cap rate of 7% and a barrier rate of between 3.944% and 5.662% (depending on the period) where, if 6-month EURIBOR fell below the barrier rate, Venice would pay 5.45%.

29. An Executive Resolution no. 2170, signed by Venice's Finance Director (Mr Dei Rossi) approved the terms of the amendment.

30. Venice performed all of its obligations under the Bear Stearns IRS, including in particular its payment obligations thereunder, up until the date of the restructuring of the Rialto Bond.

Proposals to Restructure the Rialto Bond

31. In April 2007, Venice held a tender process to invite proposals for restructuring the Rialto Bond so as to free up resources in the Municipality's balance sheet, and for a derivative to be associated with the restructured bond. Venice sent notices to seven banks, including the Banks, inviting them to submit restructuring proposals for the Rialto Bond and the Bear Stearns IRS. These were signed by Mr Dei Rossi and stated:

> "This Administration, in order to free up resources in the Municipality's balance sheet, intends to proceed with the restructuring of the 20-years bond named "Rialto" issued in December 2002 with Bank Akros for an amount equal to Euro 156.082.000,00. For this reason, the Administration invites this financial institution to formulate within the 19 c.m. a proposal to remodulate the above-mentioned debt, whose outstanding amount is as of today equal to Euro 129.267.112,40, containing the following main characteristics:
>
> - Extension of the maturity from 2022 to 2037;
> - Profile of amortization of the "amortizing" capital;

- Recovery of the resources in 2007 and 2008 with respect to the actual situation of circa Euro 7.000.000,00 for each year;

This administration also kindly request the financial institution both to deliver a proposal for an eventual derivative's transaction relating to the bond's issuance and to communicate its rating."

It is attached to this communication:

- Amortization plan of the bond "Rialto";
- Swap contract in place at the moment.

Moreover, this Administration considers completing its request by establishing a partnership relationship. The membership to the "Club dei Amici di Venezia [Club of the Friends of Venice] recently established and which for the time being count the accession of three companies leaders in their field, allows the new "Friend" to become a partner of Venice and focus its communication on the image of the city, in this way actively operating to safeguard the city's cultural, artistic assets and traditions. The status of Friends of Venice determines a partnership relationship with the Municipality of at least three years. To those companies which decide to become members, it is requested a minimum financial contribution equal to Euro 900.000,00 to be made during the entire relationship in exchange for the great visibility offered. The communication plan can be conveniently adapted to the specific needs of the company."

32. On 19 April 2007:

i) Banca Opi and BIIS wrote to Venice with an offer to restructure the Rialto Bond, comprising an advisory stage (involving assisting Venice in calling and organising the meeting of bondholders) and a subsequent IRS stage, including the cancellation of Venice's debts under the Bear Stearns IRS. The letter stated that if the "offer proposal" is accepted, the bank would undertake to carry out various activities including:

"Advise on the completion of operations involving derivative financial instruments aimed at optimizing the cost of the bond issue."

ii) Dexia wrote to Venice with a debt restructuring proposal presentation which contained a renegotiation proposal for the Rialto Bond and a swap restructuring proposal. Dexia indicated that it would be prepared to operate with other banking counterparties.

33. On 8 May 2007, Venice sent letters to the Banks asking whether it was feasible for them to offer improved terms with regard to the Rialto Bond restructuring and the membership of the "Club of the Friends of Venice" (effectively a municipal fund to which businesses transacting with Venice were asked to make contributions).

34. On 14 May 2007, the Banks submitted a joint written proposal to Venice headed 'Debt Restructuring Scenario' regarding the restructuring of the Rialto Bond and the Bear Stearns IRS (**the Joint Proposal**). The Joint Proposal envisaged two phases:

i) the provision by the Banks of assistance to Venice in relation to the calling and organising of a meeting of the Rialto Bond holders, at which a debt restructuring plan would be presented; and

ii) the entry into by the Banks and Venice of IRS transactions to replace the Bear Stearns IRS.

By a cover letter enclosing the Joint Proposal, Intesa offered to pay €930,000 to Venice as a contribution to join the Amici di Venezia (Friends of Venice), conditional on execution of the bond and derivative restructuring.

35. On 28 May 2007, Venice wrote to the Banks stating:

> "Please note that after carefully examining the offers received concerning the restructuring of the 'Rialto' bond and participation in the 'Friends of Venice Club', the Administration has decided to award the aforementioned transactions to your bank. You will be contacted in the coming days to proceed with task."

36. On 29 May 2007, the Banks gave a presentation to Venice on the consent solicitation process required for the Rialto Bond restructuring. The consent solicitation process involved the identification of, and engagement with, the Rialto Bond holders for the purposes of approving the restructuring and the drafting of the necessary documentation.

37. On 21 June 2007, the City Board passed Resolution no. 345 which resolved that the Banks be given a joint mandate "in the role of Co-Arranger, Co-Consent Coordinator and Dealers for the performance of organisation and restructuring of the [Rialto Bond] [in] particular concerning the lengthening of the maturity of [notes] to 2037 and the [restructuring] of the [Bear Stearns IRS]."

38. On 19 July 2007, the Banks and BIIS entered into a written agreement with Venice (the **Mandate Agreement**), which by Article 9 provided for choice of Italian law and the jurisdiction of the Court of Venice. The Mandate Agreement provided, inter alia, as follows:

i) Venice granted the Banks (and BIIS) a joint mandate for the 'Operation' in the role of Co-Arrangers, Co-Consent Coordinators and Dealers: Article 1.

ii) Recital C defined the 'Operation' as "a proposal to restructure [Venice's] debt, consisting of the renegotiation of the financial terms and conditions of the [Rialto Bond], also through an extension of the maturity from 2022 to 2037, and the remodulation of the overlying derivatives operation".

iii) By Article 1, Venice undertook to negotiate in good faith exclusively with the Banks (and BIIS) as swap counterparties on the terms and conditions for the execution of the restructuring of the derivative position in relation to the Rialto Bond.

iv) No commission would be payable by Venice to the Banks for the services to be provided under the Mandate Agreement: Article 2.

v) The Banks' mandate was exclusive and would last until 29 February 2009. In the event that the City Council did not approve the 'Operation', the mandate would lapse: Article 7.

There is a dispute over whether or not Article 3 of the Mandate Agreement required the Banks to advise Venice on the restructuring of the derivative position.

39. In around July 2007, the Banks instructed Clifford Chance and Venice instructed Beltramo Law Firm (**Beltramo**) in relation to the proposed Transactions. In late August and September 2007, Clifford Chance and Beltramo exchanged comments on a draft resolution for the City Council.

40. Banca Opi and BIIS both entered into the Mandate Agreement given that they both carried out activities in relation to public finance and it was not clear at the time what the eventual corporate structure of the Intesa Sanpaolo Group would be.

41. On 13 September 2007, representatives of the Banks met with Venice to discuss the restructuring of the Rialto Bond and the Bear Stearns IRS, following adverse press comment on those transactions. Venice asked the Banks to submit a document explaining the restructuring. Accordingly, that evening, Dexia (Mr Chiavari) emailed Venice (Ms Mutti and Mr Dei Rossi) a memorandum named 'Final CM Venezia'. The memorandum described the objectives that Venice aimed to achieve with the restructuring of the Rialto Bond as follows:

> "1. To extend the maturity of the bond by an additional 15 years from 2022 to 2037 (extending the average financial life from the current 8 to 20 years), thereby achieving a more convenient rescheduling of budgetary commitments;
>
> 2. To benefit from the extension of the loan at competitive conditions related to the new duration, with a maximum indicative coupon equal to Euribor 6m + 23 bps;
>
> 3. To free up resources of about €12 million in capital until the end of 2008."

42. The 13 September 2007 memorandum also stated in relation to the restructuring of the Bear Stearns IRS:

> "Following the acceptance by the bondholders of the proposed new terms and conditions and therefore the renegotiation of the bond loan, the Municipality will also carry out the restructuring of the derivative entered into in 2004 with Bear Stearns whose underlying item is the international issue in question. The legislation (Article 3 of the Circular of 27 May 2004 explaining Ministerial Decree No. 389 of 2003) provides, inter alia, that "in the event of a change in the underlying liability of a derivative, for example because it has been renegotiated [...], the position in the derivative instrument may be readjusted on the basis of conditions that do not result in a loss for the Body.
>
> Article 3(f) of the same Decree No. 389 further provides that the flows received by institutions through derivative transactions must be equal to those paid in the underlying liability.

Therefore, the Municipality, in unwinding the existing derivative, will refer to the relevant legislation in force, pursuing the objectives of an efficient active debt management and adjusting the existing derivative not only to the new underlying but also to the changed market conditions."

The Resolutions of the City Council and the Finalisation of the Terms of the Proposed Transactions

43. On 25 September 2007, the City Council issued Resolution no. 129 (**Resolution 129**). The Recital to Resolution 129 recorded, amongst other things, that:

> "Given that the Programmed Forecast Report for the 2007-2008 three-year period, attached to the 2007 Budget approved by Council Resolution No. 19 of 26 February 2007, provides for the active management of debt among the objectives to be achieved in the field of financial policies;
>
> ….. Considering that, with [Resolution 194] the City Council authorised the issuance of the [Rialto Bond];
>
> Given the resolution of the Municipal Board of 21 June 2007, No. 345 (mandate for the performance of the restructuring of the [Rialto Bond]) through which the aforesaid Council, in execution of the aforementioned Budget Report, after selection by invitation of primary banking institutions, activated with note protocol No. 160285 of 12 April 2007, jointly gave mandate to [BIIS and the Banks], as Co-Arrangers, Co-Consent Coordinators and Dealers in relation to the restructuring of the [Rialto Bond];
>
> Considered, in particular, that the joint proposal received from the aforementioned credit institutions provides for the possibility of modifying certain terms and conditions of the [Rialto Bond], including the extension of the maturity of the securities, from the current one scheduled for December 2022 up to a maximum maturity of 2037, the change in the interest rate margin, as well as the restructuring of the derivative transaction to cover the interest rate risk associated with the aforesaid issue;
>
> Considering also that the above proposal is subject to the interest in the renegotiation of the terms and conditions of the bond in question by the present holders of the bonds;
>
> Considered that the aforementioned proposal is of interest to the Municipality of Venice in consideration of the current levels of long-term interest rates and the fact that the City could achieve savings on the service of the debt by means of the aforesaid amendment to the terms and conditions of the debenture loan;
>
> Considering that the Municipality of Venice, as stated by the [Finance Director] is not in a situation of disruption or in structurally loss-making situations as defined by Article 242 of the Legislative Decree No. 267 of 18 August 2000, and that no budget deficits are recorded in the penultimate final balance;
>
> Considering that all the costs foreseen for this operation are included in the budget for the current year; Without prejudice to the fact that, following the restructuring

and renegotiation of the loan, a new financial amortisation plan must be prepared for the restructured debenture loan (Annex 1)… ."

44. Resolution 129 recorded that the total reduced expenditure of minus €3,500,000 included €3,100,000 which was "the partial use of the savings deriving from the restructuring of the [Rialto Bond]). Savings that will also be reflected in the 2008-2009 budgets". By Resolution 129, the City Council resolved (amongst other things) to:

i) authorise the changes to the terms and conditions of the Rialto Bond (Resolution 7);

ii) "also authorise the restructuring of the existing derivative transaction in relation to the [Rialto Bond] in the most appropriate forms, including the replacement of the original counterparty with the banking institutions appointed as Co-arrangers, Co-consent Coordinators and Dealers indicated in the recitals in relation to the [Rialto Bond] referred to in point 7 above), also proceeding to the drafting of the relevant ISDA contract, if applicable" (Resolution 8);

iii) authorise the Finance Department to carry out all the acts resulting from Resolution 129 (resolution 9), including:

"d. the negotiation and execution of the documentation necessary for the restructuring of the derivatives transaction relating to the same debenture loan, in compliance with the provisions of Article 41 of Law no. 448/2001 and the related implementation provisions, including the ISDA documentation (Master Agreement and Schedule) with the new "Swap" counterparties referred to in point 8 above, as well as the definition of the final terms and conditions of these restructuring transactions."

45. On 17 October 2007, Venice and the Banks entered into a Consent Solicitation Agreement, pursuant to which Venice appointed the Banks (and BIIS) as exclusive Co-Consent Coordinators in connection with the restructuring of the terms and conditions of the Rialto Bond. By clause 4, the services of the Co-Consent Coordinators were to be performed for no consideration.

46. On 26 October 2007, Mr Dei Rossi emailed Dexia (Mr Chiavari) asking for an update on the convening of the bondholders' meeting and noting that the position in relation to the Bear Stearns IRS also needed to be clarified and saying;

"I would like to remind you that the City Council asked me to be supported in the choices we make by a third party, which we identified as Brady Italia".

47. On 2 November 2007, Italian legislation transposing Directive 2004/39/EC (**MiFID**) came into force in Italy.

48. Banca Opi and Venice entered into an undated Investment Services Agreement (**the ISA**), which contained, amongst others, clauses providing for the choice of Italian law and the jurisdiction of the Italian courts: Article 15(1)-(2). A version of the ISA was circulated for signing on 14 December 2007.

49. By letters dated 10 December and 14 December 2007, Dexia and Banca Opi (respectively) informed Venice that they had classified Venice as a retail customer pursuant to MiFID. On 14 December 2007, Dexia (Ms Battista) emailed Venice (Mr Dei Rossi and Ms Mutti) concerning the obligations on financial intermediaries under MiFID, and enclosing an "information brochure" containing various documents, including a "customer classification letter" and a "client profiling questionnaire". The Banks sent draft transaction documents to Beltramo on the 18 December 2007.

50. On 13 December 2007, Mr Dei Rossi passed an Executive Resolution resolving to commit €50,000 for activities related to "active debt management" in connection with the Rialto Bond restructuring referring to, amongst other things, Beltramo and Brady Italia.

51. On 14 December 2007, Brady Italia provided Venice with a proposal for technical assistance in relation to the restructuring of the hedging strategy for the Rialto Bond. Mr Dei Rossi accepted the proposal by an email of 17 December 2007. Also on 14 December 2007, the Banks provided Venice with a letter to send to Bear Stearns requesting assignment of the Bear Stearns IRS, and contact details of the relevant person at Bear Stearns.

52. On 17 December 2007, Ms Mutti emailed the Banks to inform them that Venice would be supported by Brady Italia in relation to the restructuring of the hedging arrangements for the Rialto Bond.

53. By a letter dated 17 December, Venice formally notified Bear Stearns of Venice's intention to restructure the swaps position in relation to the Rialto Bond.

54. On 18 December 2007:

    i) Banca IMI (Giovanni D'Aversa) sent an email to Brady Italia (Mr Faro) attaching the Bear Stearns IRS Confirmation and the term-sheet for the Transactions.

    ii) Mr D'Aversa spoke to Mr Faro of Brady Italia, and then reported that Mr Faro had been surprised at the tight timetable for the closing of the derivative, about which he said he had not been notified by Venice.

    iii) Ms Mutti faxed Banca Opi a copy of Resolution 129.

    iv) Mr Dei Rossi contacted Bear Stearns (Mr Gaudenzi) asking it to give consent to Venice's request to transfer the Bear Stearns IRS to the Banks.

    v) Mr Dei Rossi completed a 'Retail Customer' questionnaire for Banca Opi, which, amongst other things, identified Venice's objectives as "Optimising the financial management of existing transactions, also taking limited risks", and described Venice's interest rate expectation as being "stability or an increase".

    vi) Mr Dei Rossi also completed a "MiFID – Customer Profiling Questionnaire: Debt Management" for Dexia, which recorded amongst other things, that Venice was familiar with "Plain vanilla derivatives (including products with cap and floor options)", that its valuations underlying financial choices were usually made "by an internal structure", that derivative transactions were monitored "with the

support of an external structure", and that the objectives of its debt management strategy included both "containing the cost of debt within a predefined range, including through its stabilisation at a constant level", and "Reducing the cost of debt by accepting the possibility of its potential increase".

55. On 19 December 2007:

i) Executive Resolution no. 3553 signed by Venice's Finance Director approving the terms of the restructured Rialto Bond was included in the Register of the Resolutions of the Manager.

ii) Banca Opi (Ms Battista) emailed Venice and its advisors setting out the procedural steps to be taken in order to effect the Transactions.

56. The restructuring of the Rialto Bond was concluded on 20 December 2007, following the bondholders' meeting at 11am CET that day at the offices of Clifford Chance in Rome, which approved the new financial characteristics of the bonds. In particular, the maturity date of the bonds was extended to 2037 and the coupon from December 2007 onwards was to be 6-month EURIBOR plus 0.21%. In order to enable the restructuring to proceed, Dexia had purchased outstanding bonds and participated in the vote as bondholder, to ensure that the quorum of 75% was reached.

57. Also on 20 December 2007:

i) Mr Dei Rossi passed Executive Resolution no. 3561 which provided:

> "Object: Execution of the derivative transaction in relation to the restructuring of the bond of EUR 156.082.000,00 entered into on 20 December 2007 – Implementation of the Municipality's Council resolution no. 129 of 25 September 2007…
>
> Having considered that on 20 December 2007 the Municipality of Venezia has restructured the 30-years floating rate bond whose original amount was qual (sic) to EUR 156.082.000,00, as resolved by the Council Resolution no. 129 of 25 September 2007;
>
> Having considered that the Municipality's Council Resolution no. 129 of 25 September 2007, which authorized the Municipality of Venezia to proceed with the restructuring of the abovementioned bond, also authorized the Finance and Accounts Interdepartmental Office to restructure the derivative transaction associated with such bond to hedge the interest rate risk;
>
> Having regard to the Municipality's Board Resolution of 21 June 2007 no. 345, which conferred a joint mandate to Banca Intesa Infrastrutture e Sviluppo S.p.A., Banca OPI S.p.A. and Dexia Crediop S.p.A. as Co-arranger, Co-Consent Coordinators and Dealers for the restructuring of the bond as well as the restructuring of the derivative transaction associated with the bond;

Having acknowledged that, in agreement with the swap counterparties (Banca Opi Spa, e Dexia Crediop Spa) have been agreed the terms of the derivative transaction whose underlying is the bond mentioned above, as well as the final versions of the relevant Confirmation, the ISDA Documentation (Master Agreement and Schedule) and the Novation Confirmation, which will be used for the assignment to Banca OPI and Dexia Crediop of the swap contract currently in place between the Municipality and Bear Stearns;

Having recognised the need to approve the final versions of the aforementioned agreed documents;

Having considered that the abovementioned documentation shall be sent to the Ministry of Economics and Finance pursuant to Article 1, para. 737 of Law no. 296 of 27 December 2007 and relevant Circular dated 31 January 2007, as condition precedent for the effectiveness of the transaction.

DETERMINES

1. to approve, in compliance with the Municipality's Council resolution no. 129 of 25 September 2007, the terms and conditions of the derivative transaction, as better described in the Confirmation attached hereto;

2. to approve the execution with Banca OPI and Dexia Crediop of the contractual documentation relating to the transaction (ISDA Master Agreement and relevant Schedule, Novation Confirmation and Confirmation) in the versions attached hereto and which form an integral part of the present resolution."

ii) Dexia (Ms Battista) emailed Venice a letter headed "Information document on the nature and risks relating to transactions in derivative financial instruments /swap" (which Mr Dei Rossi signed).

iii) Venice (Mr Dei Rossi) emailed Bear Stearns to request the assignment of the Bear Stearns IRS to the Banks, and Dexia (Mr Belarbi) emailed Bear Stearns a draft of the novation confirmation the Banks proposed to use.

iv) Venice (by a letter signed by Mr Dei Rossi) wrote to the Italian Ministry of Economy and Finance (**MEF**) notifying it pursuant to Article 41(2)(ii) of Law no. 488 of 2001 (as amended by Article 1, paragraph 737 of Law No. 296/2006) of the restructuring of the Rialto Bond and the Transactions. The letter attached (among other things) the draft Transaction Documents (**the Transaction Documents**) and stated:

"Following the renegotiation of the above-mentioned international bond effective as of today, it is necessary (including under Article 3, paragraph 3 of Italian Ministerial Decree of Economy and Finance No. 389/2003 and the Ministerial Circular of 27 May 2004 and as specified by Article 1, paragraph 736 of Italian Law No. 296/2001 and the relevant circular of the Ministry of Economy and Finance of 31 January 2007), to restructure the

derivative transaction entered into on 19 December 2005 in respect of the bond itself to adapt the swap to the new financial characteristics of the underlying bond.

The Municipality, following an informal call for tenders in accordance with Articles 19 and 27 of Italian Legislative Decree No. 163/2006, on 28 May 2007 appointed [the Banks] as of Co-Arranger, Co-Consent Coordinator and Dealers in in relation to the restructuring of the "Rialto" bond issue and the subsequent restructuring of the outstanding derivative transaction for the completion of the renegotiation of the abovementioned bond and for the restructuring of the of the related derivative transaction. Therefore, it is the intention of this City Council to proceed on 20 December 2007, with the restructuring of the above-mentioned swap contract (also following their assignment) and the conclusion of a new swap (the "Transaction"), all with a view to optimising the cost of issuing the international bond under the new terms and conditions resulting from the renegotiation of the latter. It should be noted that this City Council has decided to finalise the interest rate swap transaction, not for speculative purposes, but solely for the purpose of the hedging interest rate risk and for the proper management of its liabilities. It should also be noted that the above transactions are carried out on underlying amounts that are actually due from the Public Entity."

The Transactions

58. On 21 December 2007, Venice entered into the Transactions with the Banks in the form of:

i) an ISDA Master Agreement with accompanying schedules with each of the Banks, in English (together **the Venice Master Agreement**); and

ii) a confirmation for each of the Banks recording the terms of the relevant trades, in Italian (together **the Confirmation**).

59. The economic terms of the Transactions were agreed on a trade call prior to the execution of the Transactions on 21 December attended by Mr Gabbi (on behalf of Banca Opi), Mr Belarbi and Antonio Nardiello (on behalf of Dexia), Mr Dei Rossi (on behalf of Venice) and Ms Chiara Orsi of Brady Italia.

60. Brady Italia produced a report for Venice entitled 'Derivatives: Risk Management and Market Value – Municipality of Venice' which bears a date of 21 December 2007 (**the Brady Report**) and an NPV report. There is a dispute as to when the advice reflected in this report was provided by Brady Italia to Venice, and as to whether the report was provided by Brady Italia to Venice prior to the conclusion of the Transactions or not until 2008. My findings in relation to that issue are set out at [89]-[100] below.

61. The basic terms of the Transactions were as follows:

i) The Trade Dates were 21 December 2007, the Effective Dates were 23 June 2007 and the Termination Dates were 23 December 2037.

ii) The initial Notional Amount on the Opi Confirmation was €85,154,842.96, decreasing in accordance with the amortisation schedule at Annex A to the Opi Confirmation. The initial Notional Amount on the Dexia Confirmation was €40,072,867.28, decreasing in accordance with the amortisation schedule at Annex A to the Dexia Confirmation.

iii) Venice agreed to pay the Banks interest on the Notional Amounts (from time to time) as follows:

a) For the period 23 June 2007 to 23 December 2007, at a variable rate equal to 6 month Euribor plus 0.17% per annum.

b) For the period from 23 December 2007 to 23 June 2010:

i) At a Nominal Annual Fixed Rate of 4.67% if 6 month Euribor was less than or equal to the 'strike floor' of 4.5%;

ii) At a variable rate equal to 6 month Euribor plus 0.17% per annum if 6 month Euribor was greater than 4.5% and less than or equal to 6.50%; or

iii) At a Nominal Annual Fixed Rate of 6.67% per annum if 6 month Euribor was greater than the 'strike cap' of 6.5%;

c) For the period from 23 June 2010 to 23 December 2037:

i) at a Nominal Annual Fixed Rate of 5.465% if 6 month Euribor is less than or equal to the 'strike floor' of 5.255%;

ii) at a variable rate equal to 6 month Euribor plus 0.21% per annum if 6 month Euribor is greater than 5.255% and less than or equal to 6.79%; or

iii) at a Nominal Annual Fixed Rate of 7% per annum if 6 month Euribor was greater than the 'strike cap' of 6.79%.

d) The Banks agreed to pay Venice interest on the Notional Amounts (from time to time), as follows:

i) at a variable rate equal to 6 month Euribor plus 0.17% per annum for the period 23 June 2007 to 23 December 2007; and

ii) at a variable rate equal to 6 month Euribor plus 0.21% per annum for the period from 23 December 2007 to 23 December 2037.

e) The Payment Dates would be every 23 June and 23 December, commencing on 23 December 2007 and ending on 23 December 2037.

f) The Calculation Periods were 6 month periods, from 23 June 2007 to 23 December 2037.

62. The Novation Agreement between Bear Stearns, Venice and the relevant Bank (**the Novations**) provided that:

    i) 68% of the Notional Amount of the Bear Stearns IRS, which was equal to €85,154,842.96, be assigned from Bear Stearns to Banca Opi in consideration for a fee of €5,484,200.

    ii) 32% of the Notional Amount of the Bear Stearns IRS, which was equal to €40,072,867.28, be assigned from Bear Stearns to Dexia in consideration for a fee of €2,580,800 paid from Dexia to Bear Stearns.

63. The effect of the Novations was therefore to reduce the notional amount of the Bear Stearns IRS to zero in return for the payment of fees by the Banks to Bear Stearns. The Banks paid the fees to Bear Stearns pursuant to the Novations.

64. Also on 21 December 2007, the Banks entered into back-to-back hedging IRS transactions as follows (together, **the Hedging Swaps**):

    i) Banca Opi entered into a back-to-back IRS with Banca IMI S.p.A;

    ii) Dexia entered into a back-to-back IRS with Barclays Capital (a division of Barclays Bank plc). Dexia's 1992 ISDA Master Agreement with Barclays is dated 25 June 2003.

65. Following the execution of the Transactions, Beltramo provided final versions of the Transaction Documents to Venice for delivery to the MEF.

66. On 17 January 2008, Venice (acting by Mr Dei Rossi) sent a further letter to the MEF enclosing executed versions of the Transaction Documents and noting:

    > "With respect to this derivative transaction, it should be noted that the underlying debt transaction for an original amount of EUR 156,082,000.00 (ISIN code XS0160255856) was restructured on 20 December 2007 with an extension of the maturity date to 23 December 2037 at a variable rate equal to the six-month Euribor plus 0.21 p.p.a."

Post-Transaction Events

67. On 24 January 2008, Marco Aletti of Brady Italia submitted a draft report to Venice (which has not been disclosed) concerning the restructuring of the Rialto Bond and Bear Stearns IRS. The content of the draft report was considered by Venice in emails during February 2008.

68. On 31 October 2008 the President of the VIII Commission of the City Council asked Mr Dei Rossi to provide information concerning all of Venice's derivatives, and clarification of whether there were any implicit costs:

    > "due to low incoming cash flow against the risks of the derivative transactions in place, and what costs were incurred to exit the Rialto bond issue after endless restructures following the first contract signed in 2002 with Bear Stearns, converted on 20 December 2007 into a new derivative, this time with Dexia Crediop - OPI Bank with maturity 23 December 2037".

69. The letter stated that in the writer's opinion the Bear Stearns IRS and swaps with Merrill Lynch did not adhere to hedging purposes, and asked Mr Dei Rossi to verify whether the Transactions were binding and/or whether Venice could have legal grounds to cancel the Transactions on the ground that they were speculative.

70. Since the entry into the Transactions, the total sum paid by Venice to Dexia pursuant to the Dexia Transaction as at 1 June 2022 is €22,156,492. The total sum paid by Venice to Intesa pursuant to the OPI Transaction as at 1 June 2022 is €48,957,048.

71. The City Council passed resolutions approving Venice's annual financial statements for each of the years ending 31 December 2007 to 2021 inclusive. Each of Venice's financial statements from 2007 to date has made provision for the performance of Venice's obligations under the Transactions and included a statement describing the Transactions (and other derivative transactions to which Venice was a party), including their anticipated costs and mark-to-market (**MTM**) values.

72. By a resolution of 21 June 2018, the City Council authorised the Mayor of Venice to bring a civil liability action against the Banks in respect of derivative transactions entered into with Venice.

73. On 12 May 2020, the Joint Sections of the Italian Supreme Court of Cassation (**the Supreme Court**) issued Decision No. 8770/20 between BNL – Banca Nazionale del Lavoro S.p.A and the Municipal Authority of Cattolica (***Cattolica***). That decision has generated a new wave of Italian swaps litigation in the Commercial Court, and understandably featured prominently in the arguments advanced at the trial. The Supreme Court is the highest civil court in Italy (the highest administrative court being the Council of State).

74. On 10 December 2020, Venice sent letters to Intesa and Dexia stating that Venice would continue to make the payments envisaged by the Transaction Documents, but that the further payments which it intended to make did not constitute an admission of the validity of the Transaction Documents or prejudice Venice's claim in these proceedings that the Transaction Documents were a nullity.

D MY FINDINGS ON THE KEY FACTUAL DISPUTES

75. There were three principal factual areas of dispute. I set out my findings on each of them in this section.

Venice's Knowledge and Sophistication so far as Derivative Transactions are Concerned

76. I am satisfied that Venice (and in particular Mr Dei Rossi) had some knowledge and experience of swap transactions before it began its discussions with the Banks in relation to the Transactions, but that it would not be accurate to describe Venice as a "sophisticated" investor. While Mr Dei Rossi and Ms Mutti were able, in directional terms, to understand the significance of the movement of interest rates in a particular direction on the cap and floor of the Transactions, and when Venice would be "in" and "out" of the money (and thus the basic principles of a collar), they were not able to:

    i) arrive at any quantitative assessment of the likelihood of that happening;

ii) assess the MTM of the floor, cap or the Transactions;

iii) reach an informed view of their own of the likelihood of interest rates rising above the cap or falling below the floor during the life of the Transactions; nor

iv) assess the effect of covering the negative MTM of the Bear Stearns IRS within the proposed terms on the economics of the Transactions.

77. Such experience as Mr Dei Rossi did have was derived from the previous derivative transactions which Venice had undertaken:

i) the Bear Stearns IRS, which also had a collar structure and was therefore a structured rather than "vanilla" swap, and the two amendments thereto negotiated in 2003 and 2004; and

ii) three other derivatives contracts: two with Merrill Lynch (executed in May 2004 and March 2007), and one with Barclays (executed in April 2005), for which Mr Dei Rossi was once again responsible.

78. I also accept that through those transactions, Mr Dei Rossi had acquired some knowledge of the terms of the ISDA Master Agreement.

79. That understanding led Venice to describe its knowledge of financial instruments as "medium" in the MiFID customer profiling questionnaires which it completed for the Banks. That meant it understood "the characteristics of the fundamental instruments/financial products" and "the fundamental risks and threats". On the basis of its previous swaps experience, I can understand why Venice answered in these terms.

80. However, as a local authority, there were understandably considerable limits to Venice's understanding of transactions which had only become open to local authorities in 2001. Mr Dei Rossi and Ms Mutti were civil servants without experience in the financial markets, and in 2007 Venice's Finance Department comprised only three personnel. I have seen nothing to suggest that Venice engaged in any particularly sophisticated analysis of the Bear Stearns IRS before entering into it or restructuring it. It would appear that the original terms of the Bear Stearns IRS which Venice submitted to the MEF for approval were rejected on the basis that they were prohibited (leading Bear Stearns to revise the terms to Venice's advantage), which suggests that, at that stage, the level of Mr Dei Rossi's understanding of the regulatory regime so far as the conclusion by local authorities of derivative transactions was concerned must have been limited.

81. In 2007, both Banks classified Venice as a "retail customer" for MiFID purposes and I have concluded that that was a broadly accurate classification. In particular:

i) There is no evidence of any particularly informed internal assessment of the competing proposals by the Finance Department in 2007. The only document seeking to do so is a spreadsheet prepared by Ms Mutti – who, on the Banks' characterisation, performed an essentially administrative role – and Venice was right to describe that assessment as rudimentary, both in the lack of any consideration of the MTM of the proposals or their relationship with the forward rates curve, and particularly in only considering the period to December 2008

(over which period, the Banks' proposals brought Venice early benefits, with the net payments moving against Venice after that).

ii) While the Note on Derivatives prepared by Venice in June 2008 suggested a relatively sophisticated understanding of derivatives, I have concluded on the evidence that this was prepared with the benefit of input from Mr Diprima, who had joined Venice in 2008 from Intesa, and who had the financial market expertise which Mr Dei Rossi and Ms Mutti lacked. Mr Dei Rossi's acceptance in cross-examination that he had prepared the document was either a lapse in memory, or a reflection of the fact that he had overall responsibility for the document as Finance Director.

What Venice was Hoping to Achieve through the Transactions

82. The principal issue between the parties under this heading is whether one of the benefits which Venice was hoping to realise through the restructuring of the Bear Stearns IRS was the ability to wind-up the Bear Stearns IRS without having to pay the cost of the negative MTM on that transaction at that point.

83. By the time it put out the tender to which the Banks responded, Venice must have concluded that it would need to wind-up the Bear Stearns IRS, because Bear Stearns had not been asked to tender, and clearly was not intended to remain in the picture once the restructuring had been completed. In my view, it is improbable that Venice was merely ambivalent as to whether that was achieved by an immediate payment or rolling up that MTM in the restructured transaction. The former would have involved a large and unbudgeted payment, whereas it is clear from Venice's Programmed Forecast Report for the three-year period 2007 to 2009 (approved by the City Council on 26 February 2007) that Venice was looking to realise savings through the restructuring: something scarcely consistent with any appetite on its part for paying the cost of winding-up the Bear Stearns IRS in 2007.

84. I accept that Venice was also looking to protect itself against a rise in interest rates (and in particular a market shock significantly increasing the cost of its debt) over the extended life of the Rialto Bond, as Mr Dei Rossi confirmed (just as it had obtained some protection of this type through the Bear Stearns IRS).

85. While Venice did not expressly state in its invitation-to-tender letters of 12 April 2007 that it wished to avoid having to meet the costs of winding-up the Bear Stearns IRS then and there, it did explain that the purpose of the restructuring was to "free up resources" in its balance sheets so as to recover c.€7m for each of the 2007 and 2008 years. It also provided the banks participating in the tender with a copy of the Bear Stearns IRS and invited a proposal for a derivative transaction in relation to the restructured transaction. I accept the Banks' argument that, implicit in the invitation-to-tender read as a whole, was that Venice was looking to replace the Bear Stearns IRS without having to pay the winding-up costs.

86. The Banks' revised Joint Proposal specifically identified as one advantage of the Banks' proposal the fact that the proposed structure would permit disengagement with the Bear Stearns IRS without Venice having to pay the break costs in cash. Instead, they would be "integrated into the flows of the new swap". I am satisfied that the Banks emphasised this feature because they understood that this would be attractive to Venice.

Venice's decision on 28 May 2007 to proceed with the Banks' revised proposal confirms that the Banks' understanding was correct.

87. Once produced (and I address the question of when it was provided to Venice in the following section), the Brady Report provides a fair summary of what Venice was looking to achieve from the Transactions when it stated that they had allowed Venice to:

> "a) cancel the negative differentials provided on 24 December 2007 by the previous derivative transaction;
>
> b) set a positive differential for the first half of 2008;
>
> c) have a more favourable overall structure until 23 June 2010; and
>
> d) increase the market risk of the derivative in terms of 'overall effects on cash flows' as a result of the extension of the maturity by 15 years and the change in the spread and the floor".

88. On the receipt of that report, there was no suggestion by Venice that the first three matters were not benefits they were seeking to realise through the Transactions. I am satisfied that, by the time Mr Dei Rossi took the final decision to enter into the Transactions, they fairly reflected goals which Venice was looking to achieve through the Transactions.

Brady Italia's Role and the Brady Report

89. There is no evidence that Venice had used Brady Italia's services as advisers in relation to debt and derivative transactions before 2007, or after 2008. I am satisfied that a statement to the contrary effect in Ms Mutti's witness statement, but corrected in her evidence-in-chief, was wrong. Mr Dei Rossi could not recall any prior involvement and there is no documentary evidence of it (not even of a resolution of the City Council, the Executive Board or the Finance Director authorising the Finance Department to retain Brady Italia or to meet their fees).

90. However, press reports appeared in September 2007 referring to an investigation by the Regional Public Prosecutor's Office of the Court of Auditors into derivative transactions entered into by Venice. That led the City Council to authorise Mr Dei Rossi to instruct Brady Italia to advise Venice – something he confirmed in cross-examination, but which is also consistent with the fact that the first documents involving Brady Italia appear in the aftermath of the press reports. Brady Italia then produced a report, in relatively quick time, dated 19 September 2007 and entitled 'Debt Renegotiation Strategy: 'Rialto' Operation'. That report looked at the decision to enter into the Rialto Bond and the Bear Stearns IRS, and another transaction known as the Canaletto transaction, and how those transactions had subsequently been handled, and assessed the financial consequences of those transactions under five scenarios and their financial effect to date. It did not address the proposed restructuring of either the Rialto Bond or the Bear Stearns IRS.

91. City Council Resolution 129 approving the restructuring was passed at the meeting on 25 September 2007. Shortly after that meeting, the City Council instructed Mr Dei

Rossi to engage an independent third-party consultant to advise him in relation to the proposed restructuring of the Rialto Bond and the Bear Stearns IRS, and it is clear that Mr Dei Rossi must have approached Brady Italia to perform that role at some point before 16 October 2007. On that date, Brady Italia provided a proposal for their involvement and an associated costs estimate to Venice (as is apparent from a reference in a later document).

92. It is not clear how much information Brady Italia was provided with for the purpose of preparing their proposal, and whether or not it included the proposed terms of the Transactions. I am satisfied that Brady Italia did no meaningful work with regard to the Transactions during this period over and above what had been done to formulate the proposal in the first place. That is likely to have involved little more than obtaining a broad understanding of what was proposed to determine how much work would be required. Contrary to the Banks' suggestion, I am satisfied that Brady Italia would not have performed significant work for the purposes of preparing its proposal. In weighing the merit of the contrary suggestion, it is helpful to compare the review performed by a barrister for estimating a fee prior to obtaining an instruction with the work done if the instruction is received.

93. There is no evidence of any activity on Brady Italia's part between 16 October 2007, when its proposal was provided to Venice, and 14 December 2007, when it provided a further proposal. An internal Intesa email of 23 November 2007 referred to Venice "want[ing] the transaction to be scrutinised by Brady Italia, so they need to start updating the new structure and pricing and contact Brady" (i.e., envisaging a role for Brady Italia which had yet to commence). It was only in the second week of December that Mr Dei Rossi passed an Executive Resolution approving €50,000 of expenditure for "activities related to active debt management" and referring to the City Council's instruction that Brady Italia should provide consultancy services and operational support in relation to the restructuring, including "producing analyses and reports".

94. On Friday 14 December 2007, Brady Italia emailed their new proposal to Venice, referring to prior telephone conversations. The proposed engagement was "to provide your Administration's management with operational and decision-making support to evaluate the efficiency of the strategy proposed by your financial counterparties, intended to remodulate the coverage in place on the issuance of the 'Rialto' bond loan". The work proposed included a "focus on the analysis and impact that the swap hedge proposed by the [Banks] will have in terms of market risks and changes in cash flows on the entire debt portfolio", including by running a sensitivity analysis and performing probability calculations. Brady Italia's all-in estimate for the scope of work covered by the 14 December proposal was €11,000 ex. VAT. I accept that the proposed work was not subsequently limited to valuing the Transactions on an MTM basis on the Trade Date. If and in so far as Mr Faro's evidence suggested otherwise, I am satisfied that his recollection of such a long-distant assignment is mistaken. The scope of work would not have been narrowed without a reduction in the quoted fee, which did not happen – the amount invoiced and paid in 2008 was €11,000 ex. VAT.

95. Mr Dei Rossi accepted Brady Italia's proposal at 9.27am on 17 December 2007. Minutes later, Ms Mutti informed the Banks that Brady Italia would be interacting with them, naming Mr Faro as the point of contact. Those events are not consistent with Brady Italia working on the Transactions prior to that point. I accept that soon after these communications, Brady Italia were instructed, and the structure would have been

presented by the Banks to Brady Italia (as suggested by the email of Mr Nardiello of Dexia of 17 December 2007). The Banks sent Brady Italia a term sheet at 12.18pm on 18 December 2007, together with the Bear Stearns IRS confirmation. Mr Faro and Mr D'Aversa of Intesa then spoke, with Mr Faro saying he would inform Mr D'Aversa of the identities of the Brady Italia personnel working on the project. It is clear from Mr D'Aversa's internal email sent after that call that Mr Faro expressed considerable surprise at the very tight timetable that Brady Italia had been asked to adhere to.

96. On 19 December 2007, Dexia (Ms Battista) emailed Venice (Mr Dei Rossi and Ms Mutti), Ms Orsi of Brady Italia, and Beltramo with a summary of the procedural-administrative process for the Transactions which included "[v]erification of swap structure with the Municipality's financial advisor (Brady Italy)." That indicates that this requirement had yet to be fulfilled. The restructuring of the Rialto Bond was concluded on Thursday 20 December 2007. On the same day, Venice requested a call with the Banks, and I accept Brady Italia are likely to have participated in that call, given the internal Dexia email sent that day by Mr Nardiello.

97. The trade call for the Transactions was held on Friday 21 December 2007, following which the Transaction Documents were signed. The trade call (which was short) was attended by both Mr Dei Rossi and Ms Orsi of Brady Italia. On the trade call, as the transcript shows:

i) Ms Orsi confirmed, in answer to Dexia (Mr Nardiello), that the term sheet for the Transactions was clear and that Brady Italia agreed and approved its terms. She also made a reference to the fact that the 5.225% rate featured was slightly more favourable for Venice than the previous 5.26% rate. I accept that she would not have responded to the request for confirmation that Brady Italia had approved the Transactions unless Brady Italia had at least looked at the terms, and not identified any immediate issue with them.

ii) When asked whether Venice approved the Transactions, Mr Dei Rossi said that "the last check" was "with Brady" and asked Ms Orsi "what does Brady say about this"? Ms Orsi replied "yes", and then gave the indicative MTM valuation. Once again, I accept that Ms Orsi would not have done this without Brady Italia having performed some level of review of the Transactions, including performing their own MTM review.

iii) The two POLEIS valuations later attached to the Brady Report, and dated 21 December 2007, may well have been available to Ms Orsi during this call.

98. A relatively detailed review by Brady Italia of the Transactions is set out in the Brady Report dated 21 December 2007. I am satisfied that neither the Brady Report nor a draft of it were provided to Venice until 2008 and, therefore, after the Transactions had been entered into:

i) There are no communications and nothing by way of metadata which support the provision of a draft at any earlier stage.

ii) The earliest reference to a draft is dated 24 January 2008, which was discussed internally within Venice during February 2008, leading to at least one suggestion from Venice (made by Mr Diprima, who had joined Venice's Finance Department

after the Transactions had been entered into) as to a subject which should be addressed within the finalised report.

iii) The Brady Report was finalised by 27 February 2008. There are two Word copies of the Brady Report which the metadata shows were created on 27 February and 29 February 2008 respectively which contain the information which Mr Diprima had suggested be added on 21 February 2008.

iv) I do not believe that Brady Italia would have had time to produce any substantial written document and send it to Venice for its review in the period between 19 and 21 December 2007.

99. I am satisfied that the various versions of the report are all dated 21 December 2007 because that was the date when the Transactions closed. That included the present value illustration in section 6 (showing the savings from the Transactions discounted to their present values as at 21 December 2007) which it is clear was only included at Venice's request following internal Venice emails on 19 and 21 February 2008.

100. I am also satisfied that Brady Italia had not provided Venice with any summary of the detail later included in the Brady Report, which was not the stuff of which wholly undocumented conversations are made. However, I do not accept that Brady Italia did not provide some general indication that Venice could proceed – although possibly not going beyond what was said by Ms Orsi in the trade call. That was also consistent with Mr Dei Rossi's evidence in cross-examination (although I am satisfied that his evidence considerably overstated what Venice had been told, when suggesting that the substance or the thrust of the material in the Brady Report was communicated to Venice before the Transactions were entered into). I suspect Mr Dei Rossi would have regarded that generalised indication of assent as sufficient to comply with the City Council's instructions that he obtain advice from a specialist consultant, while recognising the significant timing pressures which everyone was working under. He would also have regarded it as justifying his affirmative answer to question 16 of the Court of Auditor's questionnaire in January 2010 (did Venice "use consultants in the decision-making and evaluation process leading up to the activation" of the Transactions?).

E INTEREST RATE SWAPS

101. There was no dispute as to the nature or key components of an IRS. It is an agreement by which two counterparties agree to make periodic interest rate payments to each other on set dates over a defined term, one party typically making payments calculated using a fixed interest rate and the other making payments calculated by reference to a floating rate, usually one of the published reference rates for borrowing for a particular term (e.g. the Euro Interbank Offered Rate or **EURIBOR** for 6 months or **6m**).

102. An IRS which takes the form of a "collar" is a structured product comprising a "cap" and a "floor" which are embedded into the terms of the IRS. Under a collar IRS, the rate payable by the floating rate party is subject to a cap (such that the rate used to calculate the payments it must make can never exceed a specified rate, even if the referenced interest rate rises above that rate). It is also subject to a floor, such that the rate payable can never fall below a specified rate, even if the reference rate does so.

103. IRS transactions are valued by an MTM calculation, which discounts the future cash flows of each party using prevailing market expectations of future interest rates at the valuation date and of the volatility of those interest rates over the term of the IRS. If, on the valuation date, the MTM value of the payments a party is to receive is less than the MTM value of the payments it is to make, the swap is said to have a negative MTM for that party.

104. In *Dexia Crediop SpA v Comune di Prato* [2015] EWHC 1746 (Comm), Walker J explained the nature and purpose of an MTM calculation as follows:

> "36. Market participants use a type of calculation known as 'mark to market", commonly abbreviated to 'MTM' … [The experts] agree that MTM is generally understood in its simplest form to mean the present value of the expected cash-flows, calculated according to a series of generally accepted conventions.
>
> 37. How this works can be seen by starting from a theoretical base in relation to the two legs of the simple IRS ... The present value of future cash flows is obtained by discounting them at market rates. If, on inception, each rate is the same as the current market discount rate then the swap is theoretically at par – each leg has a present value of zero because the promised rates equate to what can, in theory at least, be obtained in the market. In this theoretical example the MTM on inception will be zero for both sides, because the present value of what will have to be paid by the fixed leg is neither higher nor lower than the present value of what will have to be paid by the floating leg.
>
> 38. However, if the annual discount rate in the market differs from the fixed rate under the swap, then the present value of the fixed rate leg will no longer be zero. [One expert – Mr Malik, as it happens] gives an example where the swap is for a period of a year with a notional sum of €;100. Under a notional loan of €100 the notional repayment by a fixed rate borrower at the end of the year will be €105, comprising the principal of €100 and interest of €5. If the annual discount rate goes up from 5% to 6%, then the party paying the fixed rate will be paying in a year's time interest of €5 while the market would now be willing to promise to pay 6% at the end of a year. That entitlement to pay less than the market rate, when applied to a notional sum of €100, gives the fixed rate leg a positive present value of €0.95 – because at the rate of 6% that the market would give, it would be necessary only to invest €99.05 in order be entitled in a year's time to a repayment of €105. Making a further theoretical assumption that 1M Euribor is unchanged, the floating leg would continue to have a value of zero. The result will thus be that this simple IRS for a term of a year on a notional sum of €100 will have a positive revised MTM for the fixed rate payer of €0.95, and a negative revised MTM for the floating rate payer of €0.95.
>
> 39. More commonly a transaction will be more complex, involving floors or caps or other components. If so, the MTM of the transaction will be the sum of the MTM of each component.

> 40. In practice there will be numerous other complexities to take account of. One such will be the spread between bid and offer rates. In relation to any financial product traded between banks, what a bank will be prepared to pay will be less than what it will offer to receive. This difference is the spread charged by the bank for acting as market maker. One way of taking account of it is to calculate MTM on the basis of a mid-market rate halfway between the two."

105. I have described the MTM of an IRS transaction as a means of valuing a swap. They are frequently used by banks for the purpose of valuing IRS transactions on their trading books and calculating the level of collateral which needs to be provided in a collateralised transaction (although the Transactions were uncollateralised). The precise calculation of an MTM of the same IRS may vary to some degree between banks (not least because it is sometimes necessary to estimate elements in the MTM calculation and because banks have their own proprietary financial models for the purposes of performing such calculations). However, I accept Mr Malik's evidence that, when calculating an MTM for internal purposes, banks will generally use "mid-market" inputs. The expression "mid-market" reflects the fact that there will generally be a difference between the highest amount which a potential purchaser of a particular trading position is willing to pay to acquire it and the lowest amount a potential vendor of that same trading position is willing to accept to sell it (the so-called "bid offer spread"). "Mid-market" inputs average the bid and offer rates. As will be apparent from that description, a bank's MTM will not represent the price at which the bank would trade that position (whether as buyer or seller).

106. The MTM of an IRS on the date it is entered into is often referred to as the "Day 1 Present Value" or "Day 1 PV". Reflecting the fact that a bank will be looking to make a profit in entering into an IRS (in addition to covering its costs such as those of any hedging transaction it enters into in respect of that IRS), the "Day 1 PV" of an IRS entered into by a bank "selling" a fixed rate is typically a positive amount in the selling bank's favour (and hence a negative MTM for the bank's counterparty). That positive value will generally be higher when the selling bank is transacting with a non-bank counterparty (i.e., outside the inter-bank market), and will reflect factors such as the degree of competitive pressure in the market; the size and complexity of the trade and the ease with which it can be hedged; and counter-party specific factors (such as credit risk).

F THE ANALYTICAL FRAMEWORK

Which Law Applies to Which Issues?

107. The Transactions are governed by English law. That does not mean that every legal issue which arises for determination is exclusively a matter of English law. In particular, it is common ground that issues as to the capacity of Venice (as a legal person) to enter into the Transactions are to be determined by reference to Italian law: *Credit Suisse International v Stichting Vestia Groep* [2014] EWHC 3103 (Comm), [185]. This reflects the fact that, as a legal person, Venice only exists by virtue of, and within the confines imposed by, the municipal legal system which brought it into being. It is also common ground that the actual authority of those who purported to commit Venice to the Transactions is a matter of Italian law.

108. Who is to decide whether a particular issue of Italian law raises a question of capacity, or authority, or some other kind of legal challenge to the validity and efficacy of the Transactions? The Court of Appeal answered that question in *Haugesund Kommune v Depfa ACS Bank* [2012] QB, 549, confirming that characterisation is to be determined as a matter of English law. Aikens LJ explained:

> "38. The objective of conflict of laws rules is to enable a court to decide which system of law is to be applied to resolve a legal question when there is a foreign, ie non-English, element, involved in an issue. In the present case the legal question is: by which system or systems of laws do you decide whether a contract, putatively governed by English law, between a Norwegian legal entity and an Irish one, is valid and binding on the Norwegian legal entity when it is alleged that the Norwegian legal entity did not have the 'power' or the 'capacity' to enter into the contract because of the terms of a Norwegian statute concerning the ability of kommunes to conclude contracts of loan? I have deliberately used both 'powers' and 'capacity' in the last sentence. The issue to be resolved is, ultimately, whether the contract is valid or void in the circumstances described.
>
> 39. In framing the issue in this way, one is classifying, or characterising, the nature of the legal issue that has to be decided. Traditionally, that is the first stage in identifying the appropriate system of law which is to be applied to deal with the issue when non-English elements are involved, as here. The second stage is to select the rule of conflict of laws which lays down a 'connecting factor' to the relevant foreign element for that issue. And the final stage is to identify the system of law which is tied by the connecting factor to that issue."

109. Aikens LJ gave the following guidance as to how to determine whether or not a particular issue arising under another legal system raised an issue properly categorised as one of capacity for the purposes of English law:

> "47. So, I return to the question: in what sense must we interpret the word "capacity" in *Dicey*'s rule? Counsel have found no authorities in which there is any discussion of the meaning of the word for the purposes of the rule. None of the cases cited in the footnotes to *Dicey* assist on this point. It appears to be a novel issue. How the word 'capacity' is interpreted for the purposes of the rule is, as Etherton LJ has stated in his judgment, ultimately a matter of policy. In my view it is important to remember the purpose of the rule, which is to determine which systems of laws will be used, under English conflicts rules, to decide whether a 'corporation' has the ability to exercise the legal right to enter into a binding contract with a third party. If that accurately summarises the rule's purpose, then I think, following the approach of Auld LJ in the *Macmillan* case [1996]1 WLR 387, 407 that the concept of 'capacity' has to be given a broader, 'internationalist', meaning and must not be confined to the narrow definition accorded by domestic English law. In my view it should be interpreted as the legal ability of a corporation to exercise specific rights, in particular, the legal ability to enter a valid contract with a third party. So, I agree with the approach of Tomlinson J; for the purposes of English conflicts of laws, a lack of

substantive power to conclude a contract of a particular type is equivalent to a lack of 'capacity', to use English terminology.

48. For similar reasons, it seems to me that the concept of a corporation's 'constitution' must be given a broad, 'internationalist' interpretation. It is not a question of just trying to find some document, like a royal charter, or the memorandum and articles or some other written description of what the corporation is and can do. For the purposes of this English conflict of laws rule it is necessary to examine all the sources of the powers of the corporation under consideration. This will include any constitutional documents but also relevant statutes and other rules of law of the country where the corporation was created."

110. The fact that, even in a contract governed by English law, the capacity to enter into that contract is determined (in the case of a legal person) by reference to the law of the place of its incorporation makes it particularly important to distinguish issues of capacity properly so-called from other attacks on the validity and efficacy of an English law contract by reference to the law of some other legal system, including:

i) issues of illegality (English law taking a notably restrictive review as to the circumstances in which foreign law illegality is capable of impugning an English law contract); and

ii) issues of authority (because, as explained at [113] below, the fact that an agent lacks actual authority as a matter of the applicable foreign law to enter into an English law contract is not necessarily fatal to the validity of that contract).

111. In *SR Properties v Rampersad* [2022] UKPC 24, [23]-[24], Lord Leggatt distinguished between issues of capacity, illegality and authority in a domestic law context in the following terms:

"23 The concepts of ultra vires and illegality were not clearly distinguished when the ultra vires doctrine was first established in English law and have not always been clearly distinguished since. But the distinction is important. The term ultra vires, in its strict sense in which it has properly been used by the courts below in this action, refers to a situation where a corporation has no legal power (or capacity, as it is often put) to enter into a transaction. That is different from saying that it is against the law for the corporation to enter into a transaction. The two may coincide. There could in principle be a case where, for example, a corporation does not have the power to make a contract and where, even if it did have such power, it would be illegal for the corporation to do so. But lack of power or capacity and illegality are different concepts and the legal consequences of each may differ.

24 A third concept which has not always been clearly distinguished from ultra vires is that of lack of authority of a person or body to act for a corporation. Thus, it may be argued that, for example, a contract entered into or approved by the board of directors of a company is not binding on the company on the ground that it was beyond the powers of the board to make such a contract. This is different from saying that the company itself did not have

> the power to make the contract. It is a question of agency, governed by the law of agency."

112. The test to be applied when identifying issues of capacity adopted by the majority in *Haugesund* – asking whether there is a legal ability or substantive power to enter into a contract of a particular type, to be judged by reference to any constitutional documents, statutes and rules of the law of the country where the corporation is situated – can make the distinction between issues of capacity and illegality a fine one in those cases in which the limitation on capacity is said to derive from a statute or rule of law rather than a constitutional document. There appears to be limited guidance as to what factors point in favour of one or other categorisation. Without in any way suggesting that the factors identified below are exhaustive or individually determinative, I have been guided by the following considerations:

    i) Where the statute in question is of general application, rather than relating to a particular type of legal person, the argument for treating it as part of the corporation's constitution capable of raising an issue of capacity as a matter of English law analysis (as opposed to imposing a general legal prohibition on activities of a particular kind) will be weak. The more specific the application of the statute to a particular type of legal entity (e.g. a statute applying to a local authority or particular types of public body), the correspondingly stronger the argument that it defines the legal abilities or substantive powers of the corporation.

    ii) Where the proscribed activity is of a kind which is inherently wrongful, the statute in question is more likely to be a prohibition. Where, by contrast, it proscribes a particular kind of legal entity entering into a type of contract which other legal and/or natural persons are free to enter into, it is more likely that the statute is defining the legal abilities or substantive powers of the subject corporation.

    iii) Where the statute in question is both the legal source of the corporation's power to undertake a particular act, and the source of qualifications or limitations on that power the contravention of which makes the transaction void (for example where the statute confers a power to borrow on a local authority but only with national government consent, and provides that loan transactions undertaken without such consent are void), the restrictions are more likely to constitute limitations on the legal ability or substantive power of the corporation to enter into a valid contract of that kind, rather than a prohibition. In *Haugesund*, [58], Aikens LJ noted that the effect of the statutory provision in issue was:

    > "both to grant power … to conclude certain types of loan contract and also to restrict their power to conclude certain types of loan … Tomlinson J was well aware of the distinction between the communes having the power to enter into the swaps contracts but being prohibited from doing so as opposed to the communes not having power to do so at all. In my view he correctly concluded that the effect of [the provision] was the latter and not the former".

    iv) The fact that, under the legal system in question, legal persons have general capacity to enter into contracts is not necessarily determinative of the question of whether other limitations on the freedom of the corporation to enter into valid

contracts of a particular kind raise issues of capacity as a matter of English law categorisation. Taking a legal system which both recognises a general capacity of legal persons, but also a provision of the kind considered in the previous sub-paragraph, that can be rationalised on the basis that a *lex specialis* overrides a *lex generalis*.

113. So far as questions of authority are concerned:

i) The question of whether an agent has actual authority to commit its principal to an English law contract is governed by the law applicable to the relationship between the principal and agent.

ii) The apparent authority of that agent to commit the principal to such a contract, and the question of whether the principal has subsequently ratified the contract, are governed by English law.

iii) The consequences of the agent's lack of authority (actual or apparent) and the consequences of ratification of the English law contract are matters of English law.

(*Vestia*, [276] and *Deutsche Bank AG London v Comune di Busto Arsizio* [2021] EWHC 2706 (Comm), [377] and [382] (***Busto***)).

114. Finally, issues may arise as to the material validity of a contract: for example, whether there has been a coincidence of offer and acceptance, whether the terms are sufficiently certain to give rise to binding obligations and whether the parties intended to create legal relations. In a case such as the present, those are to be determined by English law as the applicable law of the Transactions (*Dicey, Morris and Collins on the Conflict of Laws* (15th), [32-107] and *Busto*, [263]).

The Date at which the Content of Italian Law is to be Ascertained

115. The issues of whether Venice had capacity to enter into the Transactions, whether those who signed the Transactions on Venice's behalf had authority to do so, or whether the Transactions were illegal under Italian law, are all to be determined by reference to the law in force when the Transactions were entered into. That outcome can be reached by a number of legal routes, including on the basis that it forms part of the test of categorisation to be applied under English conflict of laws rules (which in these respects does not refer the relevant issue to Italian law generally but to Italian law at the relevant date).

116. In *Adams v National Bank of Greece* [1961] AC 255, bonds issued by one Greek bank and an associated guarantee issued by another Greek bank in 1927 were governed by English law. In 1953, a third Greek bank ("the successor bank") succeeded to the rights and obligations of the guarantor bank, by virtue of Greek legislation to that effect. However, in 1956 the Greek parliament passed further legislation which retrospectively excluded the obligations under the bonds and the guarantee from the scope of that succession. It was argued that this had the effect of discharging the successor bank's liability under the English law contracts. That argument succeeded before the Court of Appeal ([1960] 1 QB 64, 81-2), Morris LJ memorably remarking:

"What the plaintiffs have done in the present actions is in the first place to assert and to rely upon Greek law, but to set up Greek law in the form in which it was enacted in February, 1953, and which was to their advantage and to claim to be entitled to ignore the amendments to the Greek law made in July, 1956, which are to their disadvantage. The question raised in the appeals is whether so singular a process of selectiveness can be justified.

It seems to us that those who need recourse to Greek law must take it as they find it. If they assert that Greek law can endow, they must recognise that Greek law can disendow. If they aver that Greek law can create, they must accept that Greek law can change. If they need to have the foundation of Greek law upon which to build a claim, they can hardly say that Greek law as it used to be suits them far better than Greek law as it is".

117. However, that decision was overturned in the House of Lords, albeit their Lordships reasons for doing so differed in some respects:

i) Viscount Simonds held that, once the contractual obligation governed by English law had come into existence, no alteration of Greek law would be effective in an English court to discharge that obligation as a matter of conflicts of law analysis (pp.274-275).

ii) Lord Reid held that the effect of the 1953 legislation was that the successor bank became bound to the English law contract, which obligations were thereafter independent of Greek law (p.279). The English courts could not give effect to a foreign law discharging an English law obligation to pay money in England (p.281), and the question of whether the 1956 law was seeking to discharge English law obligations was to be determined as a matter of substance and not form (pp.282-283).

iii) Lord Radcliffe held that once the successor bank's English law obligations had come into existence, they could not be discharged by subsequent Greek legislation, and also that "once the validity and consequences of a succession created by foreign law have become established by its rules" it would be "neither just nor convenient … that an English court … should recognise retrospective alterations of that succession which may be propounded by the foreign law" (p.284).

iv) Lord Tucker held that the English courts would only recognise the laws of succession in the form they existed at the date of succession (p.285).

v) Lord Denning held that the English courts should refuse to recognise the 1953 legislation to the extent amended by the1956 legislation because that outcome was "so inconsistent with the essence of the transaction, that there is no comity of nations which requires the English courts to recognise it" (p.290).

118. That approach is relatively easy to apply in the case of legislation (as in *Adams*), or a government decree of the kind considered in *Lynch v Provisional Government of Paraguay* (1869-72) LR 2 PD 268, but rather more difficult to apply to court decisions as to the meaning and effect of existing legislative instruments, or official guidance as to their meaning. This is an issue which presents difficulties for our own legal system,

in which case law is a source of law, and which adopts the "declaratory" theory as to the effect of judicial decisions on points of law. Those difficulties have led to consideration by the Supreme Court in this jurisdiction as to whether it should have the power to overrule a previous interpretation or holding with prospective effect only. In *Re Spectrum Plus Ltd (In Liquidation)* [2005] UKHL 41, [40], Lord Nicholls observed:

> "Instances where this power has been used in courts elsewhere suggest there could be circumstances in this country where prospective overruling would be necessary to serve the underlying objective of the courts of this country: to administer justice fairly and in accordance with the law. There could be cases where a decision on an issue of law, whether common law or statute law, was unavoidable but the decision would have such gravely unfair and disruptive consequences for past transactions or happenings that this House would be compelled to depart from the normal principles relating to the retrospective and prospective effect of court decisions."

However, that remains a constitutionally controversial topic, which has yet to venture from the realm of legal theory to practical application.

119. The issue of whether there could ever be a (post-contractual) change in the interpretation or application of legislation in another jurisdiction in force when an English law contract was concluded of so significant a kind that an English court would refuse to give effect to (or recognise) that change on the basis of the principles recognised in *Adams*, was not raised in this case. An argument on *Adams* lines would be fraught with complexity and implications for judicial comity. The Banks did, however, rely on what they said would be the extensive retrospective implications of some of the Italian court decisions relied upon by Venice for antecedent transactions, when inviting the court to determine that those decisions did not correctly reflect Italian law.

The Approach to Ascertaining the Content of Italian law

120. The principles to be applied by the court when seeking to ascertain the content of foreign law were summarised by Cockerill J in *Busto*, [105]-[108]. There was no challenge to that summary in this case, and I shall not repeat it. However, there is one aspect of that summary which merits further elaboration – the approach to be taken when there are decisions of the courts of the relevant jurisdiction interpreting legislative or constitutional provisions, and the English court is asked to accept expert evidence that those decisions are wrong.

121. It has been observed that the purpose of expert evidence on foreign law "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 – emphasis added). Equally, it is not the role of the English judge to impose their own personal views as to what the foreign law *should* be. *MCC Proceeds* was a case in which the relevant foreign legal system was one in which court decisions were a source of law, and it is possible to read Evans LJ's reference to "predict[ing] the likely decision of a foreign court" with that limitation in mind. However, even when considering a civil law system, the decisions of foreign courts play an important role in ascertaining the content of foreign law. Thus, when the relevant issue is the interpretation of a foreign statute or decree, the English

court does not confine itself to construing the language, but ascertains the effect of the instrument "as shown by its exposition, interpretation *and adjudication"*(*Baron de Bode's Case* (1854) 8 QB 208, 266 – emphasis added). Scott LJ in *A/S Tallinna Laevahauisus v Estonian State Steamship Line* (1946) 80 LL L Rep 99, 108, said that when the court is faced with a dispute as to the legal effect of a foreign instrument, "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*" (emphasis added). Simon J in *Yukos Capital Sarl v OJSC Oil Company Rosneft* [2014] EWHC 2188 (Comm), [26] noted that it was "not the court's function to interpret" the provisions of (in that case) Russian legislation, but "to determine how the Russian courts have (or would) interpret them".

122. The editors of *Dicey, Morris & Collins on The Conflict of Laws* (15th) observe at [9.20]

> "Considerable weight is usually given to the decisions of foreign courts as evidence of foreign law … But the court is not bound to apply a foreign decision if it is satisfied, as a result of all the evidence, that the decision does not accurately represent the foreign law. 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."

123. The need for the English court to resolve a conflict between inconsistent court decisions in the relevant jurisdiction requires no further explanation. However, it is worth pausing over the statement that "the court is not bound to apply a foreign decision if it is satisfied, as a result of all the evidence, that the decision does not accurately represent the foreign law". The principal authority cited for that proposition is *Guaranty Trust Corp of New York v Hannay* [1918] 2 KB 623 (the other case, *Callwood v Callwood* [1960] AC 659, involved the English court not following a US court's decision as to the effect of Danish law when addressing a different question, and therefore provides no assistance on the issue under discussion).

124. In *Hannay*, the issue which arose was whether the obligation arising under a bill of exchange was conditional. That very issue, in respect of the same bill and between the same parties, had been resolved to one effect by a New York State first instance judge, but the (English) Court of Appeal concluded that that decision was not correct as a matter of New York law. The decision is, perhaps, rather less bold than the summary in *Dicey, Morris & Collins* might suggest:

    i) It was actually a "conflict of decisions" case, there being other New York authority (or decisions from other states on the same wording) to the contrary effect.

    ii) The law of New York relating to negotiable instruments was "expressed in a statute which in all material respects is identical with our own Bills of Exchange Act 1882 and was adopted for the express purposes of assimilating the law of New York to that of England" (p.654).

    iii) The decision not followed was one of a puisne judge. It was recognised, certainly by Pickford LJ, that had the decision been one of the New York Court of Appeals,

the court would not have felt able to come to a different conclusion as to the position under New York law (pp.638, 644).

125. The more senior the court which gives the relevant court decision, or the greater the number of foreign court decisions to a particular effect, the more difficult it will be for the English court to conclude that, nonetheless, those decisions do not reflect the law of the relevant jurisdiction. Pickford LJ's statement in *Hannay* was endorsed by Scrutton LJ in *Bankers & Shippers Insurance Company of New York v Liverpool Marine & General Insurance Company Limited* (1925) 21 Ll L Rep 86, 91 (observing that it was "almost certain" that an English court would follow a decision of the Supreme Court of New York on the interpretation of the New York Arbitration Act 1920), and by Lords Buckmaster and Sumner in the House of Lords in the same case ((1926) 24 Ll L Rep 85, 93-94). More recently, Simon J in *Yukos Capital Sarl v OJSC Oil Company Rosneft* [2014] EWHC 2188 (Comm), [27(3)] observed that if there is a "clear decision of the highest foreign court on the issue of foreign law, other evidence will carry little weight against it".

126. That is so even if, as has been alleged in this case, the decisions are unworkable in commercial practice or their reasoning illogical or inconsistent. When it falls to an English court to ascertain the content of foreign law, that means the law with whatever imperfections, policy-orientated determinations and impracticalities it manifests, unless the high threshold for non-recognition is satisfied, or it is possible to formulate some alternative argument by reference to the considerations discussed at [115]-[119] above. The legal system of another country for these purposes is the picture in the attic, not what (to English eyes at least) might seem to be its most idealised expression. The converse is equally true.

127. Finally, in *Yukos Capital Sarl v OJSC Oil Company Rosneft* [2014] EWHC 2188 (Comm), Simon J considered the position "where the foreign law is going through a period of change" ([30]). He noted that it was for the English court to decide "what conclusion a foreign court would reach on a developing area of the law" but not "to make findings which went beyond the present state of Russian law and to anticipate a rational development of it". In my view, those observations also apply to any anticipation of a rational restoration of the pre-development status quo.

G THE ARGUMENT THAT VENICE LACKED CAPACITY TO ENTER INTO THE TRANSACTIONS: AN INTRODUCTION

The Capacity Arguments Introduced

128. Venice contends that three of the arguments which it raises have the effect that it lacked capacity to enter into the Transactions:

i) The argument that the Transactions were speculative, and as a local authority Venice lacked capacity to enter into speculative derivatives as a matter of Italian law (**the Speculation Argument**).

ii) The argument that the Transactions constituted indebtedness other than for investment expenditure, and as a local authority Venice was not permitted to have recourse to indebtedness otherwise that for the purpose of investment (**the Indebtedness Argument**).

iii) The argument that the Transactions did not receive the requisite approval from the City Council, and Venice consequently lacked capacity to enter into the Transactions (**the Article 42 TUEL Argument**).

The Key Legislative and Administrative Instruments

129. In order to understand the discussion which follows, it is helpful at this stage to set out the key legislative and administrative documents which feature in that part of the case directed to Venice's capacity by way of a chronological overview.

130. In terms of both chronology and hierarchy, it is possible to begin with Article 119 of the Italian Constitution, originally adopted in 1947, which provides:

> "(1) Municipalities, Provinces, Metropolitan Cities and Regions shall have financial autonomy in terms of revenue and expenditure [in observance of the equilibrium of the relative budgets, and shall contribute to ensuring the observance of the economic and financial constraints deriving from the legal system of the European Union].
>
> (2) Municipalities, Provinces, Metropolitan Cities and Regions shall have independent financial resources. They set and apply taxes and revenues of their own, in compliance with the Constitution and according to the principles of coordination of State finances and of the tax system. They have co-participation in the tax revenues related to their respective territories. …
>
> (4) Revenues deriving from the above mentioned sources shall enable Municipalities, Provinces, Metropolitan Cities and Regions to fully finance the public functions assigned to them.
>
> …
>
> (6) …Municipalities, Provinces, Metropolitan Cities and Regions have their own assets, allocated to them pursuant to general principles laid down in the State law. *They may have recourse to indebtedness only for the purpose of financing investment expenditures* [with the simultaneous definition of amortization plans and provided that the budget balance is complied with reference to all entities of each region]. Any State guarantee on loans taken out by them is excluded."

131. The italicised provision features prominently in this litigation. The words in square brackets were added by Article 4 paragraph 1 of Constitutional Law No 1/2012.

132. So far as local authorities were concerned, Article 2 of Regulation 420/1996 provides:

> "1. In order to hedge against exchange rate risk, all bonds in foreign currency must be accompanied, at the time of issuance, by a corresponding swap transaction. The swap transaction shall convert, for the issuer, the bond in foreign currency into a bond in lire, without introducing risk elements".

133. When these regulations were introduced, local authorities could not enter into IRS transactions (as opposed to foreign exchange swaps), but private corporations could, and, in that context, it was relevant for certain regulatory purposes to determine whether

or not an IRS was a hedging transaction. In response to a query on this subject from one such corporation, on 26 February 1999, the Italian financial regulator (**CONSOB**) issued determination no. DI/99013791 (the "**CONSOB Determination**"). It provided that a transaction qualified as 'hedging' if the following conditions were met:

i) The transaction is explicitly carried out to reduce the risks connected with an underlying debt instrument.

ii) There is a 'high correlation' between the characteristics of the underlying debt and those of the derivative transaction.

iii) There are procedures and internal controls within the intermediary which are sufficient to make sure that the above conditions are satisfied (the significance of this third element being a matter of dispute).

134. A significant reform was made to the governance of Italian local authorities by the Local Authorities Consolidations Act (Consolidated Code of Local Bodies) or **TUEL** implemented by Italian Legislative Decree No 267 dated 18 August 2000. In particular, TUEL contained provisions which defined the respective responsibilities of a local authority's city council, executive board and executives. Article 42(1) of TUEL provided:

> "Attributions of City and Province Councils
>
> 1. City and Province Councils are the political-administrative guidance and control bodies.
>
> 2. City and Province Councils shall be responsible only in respect of the following fundamental acts:
>
>   i) expenditure which commit the budgets for subsequent financial years, with the exception of expenditure relating to the rental of buildings and the supply of goods and services on a continuing basis."

135. In December 2001, Finance Law No 448/2001 (**the 2002 Finance Law**) was enacted which gave local authorities the power to borrow and expressly permitted them to enter into derivative transactions for certain purposes including, for the first time, IRS transactions. Article 41 of the 2002 Finance Law provides:

> "(1) In order to contain the cost of debt and to monitor public finance developments, the MEF coordinates access to the capital markets of the provinces, municipalities, unions of municipalities, metropolitan cities, mountain communities and island communities … as well as consortia of local authorities and regions. To this end, these entities regularly send data on their financial situation to the Ministry. The content and data coordination and transmission methods are established by decree of the MEF to be issued jointly with the Ministry of the Interior, after consultation with the Unified Conference referred to in article 8 of Legislative Decree no. 281 of 28 August 1997, within thirty days from the date of entry into force of this law. The same decree approves the rules on debt amortisation and on the use of derivatives by the above entities.

(2) The bodies referred to in paragraph 1 may issue bonds with the reimbursement of capital in a lump sum on expiry, subject to the creation – at the moment of issuance – of a fund for amortizing debt, or subject to the conclusion of swap contracts for the amortization of the debt. Without prejudice to the provision of the relevant contractual arrangements, the entities may provide for the conversion of mortgages taken out after 31 December 1996, also through the placement of new bond issues or through the re-negotiation, also with other institutions, of mortgages, under refinancing conditions that allow a reduction of the financial value of total liabilities to be paid by the bodies themselves net of fees and of the possible downgrading of the substitute tax proceeds mentioned in article 2 of Legislative Decree no 239 of 1 April 1996, and subsequent amendments."

136. Pursuant to that power, Decree 389 was issued by the MEF on 1 December 2003 (**Decree 389**), Article 3.2 of which provided:

"In addition to the transactions referred to in paragraph 1 of this article and article 2 of this decree, the following derivative transactions are also allowed:

a) interest rate swap between two parties taking the commitment to regularly exchange interest flows connected to major financial market parameters according to the procedures, timing and conditions stated in the contract;

b) purchase of a forward rate agreement in which two parties agree on the interest rate that the buyer agrees to pay on a capital at a future date;

c) purchase of an interest rate cap in which the buyer is protected from increases in the interest rate payable above the set level;

d) purchase of an interest rate collar in which the buyer is guaranteed an interest rate to be paid, fluctuating within a pre-determined minimum and maximum;

e) other derivative products containing combinations of the above that enable the transition from a fixed rate to floating rate and vice versa when a predefined threshold has been reached or after an established period of time;

f) other derivative products aimed at restructuring debt, only if they do not have a maturity subsequent to that of the underlying liabilities. These transactions are allowed when the flows received by the interested bodies are equal to those paid in the underlying liabilities and do not involve, at the time of their conclusion, an increasing profile of the present values of single payment flows, with the exception of a discount or premium to be paid at the conclusion of the transactions, not exceeding 1% of the notional of the underlying liability."

137. On 24 December 2003, Finance Law 350/2003 (**the 2004 Finance Law**) was enacted. Article 3 addressed the concepts of indebtedness and investment in Article 119.

138. Article 3.17 provided:

"For entities, referred to in paragraph 16 above, pursuant to article 119(6) of the Constitution, the following constitute indebtedness: the assumption of mortgages/loans, the issue of bonds, securitizations of future flows of income not linked to a pre-existent financial activity and securitization with initial charge less than 85 percent of the market price of the object of securitization rated by an independent and specialized body. In addition, constitute indebtedness also securitizations accompanied by guarantees provided by public administrations, and securitizations and the assignment of receivables due from other public administrations. Operations that do not involve additional resources, but permit to overcome, within the maximum limit established by current State legislation, a temporary shortage of liquidity and to incur expenses that already have a suitable budget cover, do not constitute indebtedness, pursuant to the aforementioned article 119".

139. Article 3.18 provided:

"For the purposes of article 119(6) of the Constitution, the following are investments:

a) the acquisition, construction, renovation and extraordinary maintenance of property, consisting of both residential and non-residential buildings;

b) the construction, demolition, renovation, restoration and extraordinary maintenance of works and facilities;

c) the purchase of machinery, technical and scientific equipment, means of transport and other mobile equipment for long-term use;

d) charges for non-material assets for long-term use;

e) acquisition of land, expropriation and easements;

f) share holdings and capital contributions, within the extent of the possibility to participate granted to the single borrowing institutions by their respective rules;

g) capital transfers specifically earmarked for the implementation of the investment by another agency or organization within the public administration;

h) capital transfers in favour of subjects with public works licenses, or owners or operators of facilities, networks or equipment functional to the delivery of public services, or entities that provide public services, whose1icenses or service contracts provide for the retrocession of investments to the purchasing institutions as they mature, or in advance. The financial intervention in favor of the licensee referred to in paragraph 2, article 19, Law no. 109 of 11 February 1994 is comprised therein;

i) the interventions contained in the general implementation and execution programs related to urban planning declared a primary regional interest with a public purpose to recover and to promote the area."

140. An explanatory circular was issued by the MEF on 27 May 2004 (**the 2004 MEF Circular**) to clarify the interpretation of Decree 389. This provided:

> "Implicit in the purchase of the collar is the purchase of a cap and the simultaneous sale of a floor, which is permitted solely for the purpose of financing the protection against rising interest rates provided by the purchase of the cap."

141. Article 1 of Law 296/2006 of 27 December 2006 provided:

> "… The rules of this paragraph are core principles for the coordination of public finance mentioned in articles 117, third paragraph and 119, second paragraph, of the Constitution. Debt management transactions that use derivatives, performed by regions and entities referred to in the consolidated act referred to in Legislative Decree no 267of 18 August 2000, must be aimed at the reduction of the final cost of debt and at reducing exposure to market risks. Entities may enter into such transactions only on corresponding due liabilities, having regard to the hedging of the undertaken credit risks".

142. The MEF issued a further circular on 22 June 2007 (**the 2007 MEF Circular**) which provided:

> "1) … Following the legislative amendments that occurred on derivative instruments and on the definition of indebtedness, and also in light of the evolution of local authorities' resorting to the derivatives market, there is the need to clarify some interpretative aspects regarding the use of delegations of payment disciplined by Article 206 of the Local Authorities' Consolidated Act (TUEL) – Legislative Decree of 18 August 2000, no. 267.
>
> It seems appropriate to remind that the explanatory Circular of the MEF Decree 389/2003 already included a general consideration such that no derivative is classifiable as a liability.
>
> Therefore, derivatives are identified, according to the rules mentioned above, as "debt management instruments and not as indebtedness".
>
> 2) Article 3, paragraph 17, Law of 24 December 2003, n.350, amended by Article 1, paragraph 739, Law of 27 December 2006, no. 296 – Definition of indebtedness
>
> "Article 119, sixth paragraph, of the Constitution indicates that "Municipalities, Provinces, metropolitan cities and Regions […]. May have recourse to indebtedness only to fund investment expenses. […]". In the implementation of this constitutional principle, the 2004 Financial Law (Law 350/2003) gave a precise and detailed definition of the concept of indebtedness, indicating the types of transactions to be considered as such in reference to the abovementioned constitutional law….
>
> In conclusion, the definition of swap as mere instrument of debt "management" is further confirmed by the fact that derivative instruments are not mentioned in any of the abovementioned provisions of law;

therefore, in light of the above, derivative instruments do not qualify as indebtedness transactions."

143. With effect from 1 January 2007, Article 41 of the 2002 Finance Law was amended to add a new sub-paragraph 2 bis:

> "From 1 January 2007 within the public finance coordination framework, mentioned in article 119 of the Constitution, the contracts with which the regions and entities, referred to in the consolidated act referred to in Legislative Decree no. 267 of 18 August 2000, set up debt sinking transactions with single payment at maturity, and derivative transactions, must be transmitted, by the contracting authorities, to the Ministry of Economy and Finance – Treasury Department. This transmission, which must occur before the signing of the contracts themselves, is a constitutive element of the effectiveness of the same. The provisions of the decree referred to in paragraph 1 of this article, relating to monitoring, remain valid."

144. It is at this point that the Transactions were entered into.

145. Law No 244 of 24 December 2007 introduced further provisions intended to regulate the entry by Italian local authorities into derivative transactions. Paragraph 381 provided that "financial instrument contracts – including derivatives – signed by Regions and local entities should heed the principle of maximum transparency", and paragraph 383 required the local authority to "certify unequivocally that it is fully aware of their risks and characteristics, making clear, in a specific note attached to the balance sheet, the financial commitments and undertakings arising from such activities". It also required such transactions to follow a form approved by the MEF (paragraph 382).

146. Article 62 of Law Decree no. 112 of 25 June 2008 (**the 2008 Decree**) made a number of significant amendments in relation to the entry into IRS transactions by local authorities:

i) Article 62(6) (as later amended) stated that the local authorities "are prohibited from entering into … contracts relating to derivative financial instruments" until new regulations to be made by the MEF came into force, and in any case for a minimum period. However, "there still remains the possibility of restructuring the derivative contract following change in the liability to which the same derivative contract refers, in order to maintain the correspondence between the renegotiated liability and the related hedging transaction".

ii) Article 62(9) amended Article 3.17 of the 2004 Finance Law with effect from 1 January 2009 so as to provide that indebtedness included "on the basis of the criteria defined at European level by the Statistical Officer of the European Communities (EUROSTAT), any premium received at the entry into derivative transactions". By way of further explanation, a premium – sometimes referred to as an "upfront" – is a payment made by the bank at the time of transacting (I address the issue of whether such a payment had to be made to the bank's counterparty at [261] below). A bank who paid an upfront would transact on more advantageous terms (for the bank) than one who did not, those improved terms being provided as the quid pro quo for the payment.

147. On 27 December 2013, Article 1, paragraph 572 of Law 147/2013 (**the 2013 Finance Law**) amended Article 62 of decree-law no. 112 of 25 June 2008 (as subsequently amended) to the following effect:

> "3. Without prejudice to the provisions of the following paragraphs, the institutions referred to in paragraph 2 are prohibited from:
>
> a) entering into contracts relating to derivative financial instruments provided for by article 1, paragraph 3, of the Consolidated Financial Law, as per Legislative Decree no. 58 of 24 February 1998;
>
> b) renegotiating derivative contracts already in place at the date of entry into force of this provision;
>
> c) entering into financing contracts that include derivative components."

148. It will be apparent from this summary that:

i) After an initial liberalisation of the ability of local authorities to enter into derivative transactions, there has been a progressive tightening of the position, culminating in the general prohibition (with limited exceptions) effected by the 2013 Finance Law.

ii) Many of the provisions – particularly those which appear in primary legislation – appear in broadly drafted language, which has been "fleshed out" over time.

The Italian Swaps Crisis

149. There are helpful explanations of the background to the Italian swaps litigation in articles by Mario Anolli and Andrea Perrone, "Italian Case Law on Derivative Contracts: An Interdisciplinary Analysis" (2020) III(II) Revista di Diritto Bancario 195 (which was an exhibit to one of Professor Gentili's reports) and Andrea Berti, "The 'Derivative' Contracts of Public Bodies: Between Negotiating Authority Autonomy and the Principle of Legality" *Crisi d'impresa e Insolvenza* 2020, 1 (**the Berti Article**), which Venice placed before the court and which was written shortly after the *Cattolica* judgment. The Banks submitted that no reliance should be placed on the Berti Article because it was not referred to in the experts' reports or put to any expert in cross-examination, Berti was Cattolica's in-house counsel and the journal in which the articles was published is not an authoritative academic journal. I have placed no reliance on the Berti Article for the purposes of identifying the *content* of Italian law. However, the summary it provides of the background to *Cattolica* is not substantially in dispute and is amply supported by the various cases and articles which were exhibited by the experts.

150. In summary, the fall in floating market interest rates beginning at the end of 2000 was the occasion for a number of Italian local authorities to take advantage of their new ability to enter into IRS transactions, by which they sought to take the benefit of those lower floating rates. When interest rates began to rise in 2005, many of those contracts were "restructured" on revised terms. When restructuring those transactions – frequently in connection with an extension of the period for repayment of the underlying debts – it was often necessary to address what was, from the local authority's

perspective, the negative MTM under the existing swap. This was often done not by the local authority making a payment to the bank sufficient to close out the existing transaction, but by adjusting the terms of the restructured swap in such a way as to make the bank whole in respect of the negative MTM under the original swap. However, the 2008 financial crisis led to a dramatic reduction in (and even negative) interest rates. The result was that many local authorities found themselves paying higher fixed rate interest on their borrowings but receiving very much lower floating rate payments under their swap.

151. A report of the Bank of Italy published on 28 February 2020 refers to 98 local authorities being party to outstanding derivative contracts with negative MTMs of over €1 billion. Anolli and Perrone suggest that, as at 31 March 2020, data compiled by the MEF records 1,676 derivative contracts having been entered into by local authorities with a notional value of over €50 billion.

152. The increasingly disadvantageous terms of the swap transactions entered into by Italian local authorities as against prevailing market rates, and the corresponding strain imposed on local authority finances, resulted in a significant volume of litigation. Many of those disputes were raised before the Italian civil or administrative courts. Where, however, the local authorities had entered into IRS transactions on the terms of the ISDA Master Agreement, the transactions in question were subject to English law and English jurisdiction. As a result, disputes relating to IRS transactions entered into by Italian local authorities began appearing in the Commercial Court.

Italian Swaps Litigation in the English Courts

153. Disputes involving Italian local authorities who had entered into English law swaps transactions first began to appear in the Commercial Court in 2009 and 2010. The initial disputes were jurisdictional in nature (*Depfa Bank plc v Provincia di Pisa* [2010] EWHC 1148 (Comm), [2012] EWHC 687 (Comm); *UBS Ltd and Another v Regione Calabria* [2012] EWHC 699 (Comm) and later *Dexia Crediop S.P.A. v Provincia Di Brescia* [2016] EWHC 3261 (Comm) and *Deutsche Bank AG v Comune di Savona* [2017] EWHC 1013 (Comm); [2018] EWCA Civ 1740), or applications by the banks for declarations as to the validity of the swap transaction in response to actual or threatened litigation in Italy *(Merrill Lynch v Comune Di Verona* [2012] EWHC 1407 (Comm), in which the local authority did not appear, and *Dexia Crediop SPA v Provincia Di Crotone* [2013] EWHC 3363 (Comm) in which it did, and summary judgment was refused).

154. In this early phase of the Italian swaps litigation in the English courts, the courts had cause to engage with the merits of the complaints raised by Italian local authorities in two cases.

155. The first was a dispute between two banks, arising from litigation in which it was *a bank* which contended that the swaps were void: *HSH Nordbank AG v Intesa Sapaolo SPA* [2014] EWHC 142 (Comm). The defendant bank had entered into an interest rate swap with the Comune di Benevento in 2005. There was an agreement to restructure the 2005 swap, leading to a new swap – the 2006 swap – between the defendant and the comune. That swap was itself novated to the claimant pursuant to a three-way agreement between the two banks and the comune, under which the claimant made a substantial payment to the defendant. The claimant entered into a fresh swap with the

comune (the 2007 swap). Following certain investigations, reports and decisions in Italy, the claimant sued the comune for a declaration that the 2007 swap was void, Those proceedings settled. The claimant then sued the defendant for a declaration that the 2006 swap had been avoided, with the result that the novation agreement was not binding. The arguments raised considered some of the legislative provisions at issue in this case, the 2002 Finance Law, Decree 389 and the 2004 MEF Circular. On the basis of the expert evidence before him, Burton J rejected the contention that the 2006 swap was void.

156. The second arose from an application made by a local authority, who had not previously engaged in the proceedings, to set aside a declaratory judgment obtained by two banks as to the validity of the swaps transaction the local authority had purported to enter into: *Intesa sanpaolo s.p.a. v Regione Piemonte; Dexia Crediop S.p.A. v Regione Piemonte* [2013] EWHC 1994 (Comm). For the purposes of seeking to persuade the court that it was appropriate to exercise its discretion to set the summary judgment aside, the region contended that it had strong arguments that the swaps in issue were not binding as a matter of Italian law. That argument failed before Eder J. The possible defences to the claim were advanced "in a most unsatisfactory way" in "inchoate and tentative" terms. For that reason, the Judge dealt with them relatively succinctly. However, those issues were given rather greater consideration in an oral hearing of the local authority's application for permission to appeal which was dealt with at a rolled-up hearing (*Regione Piemonte v Dexia Crediop Spa* [2014] EWCA Civ 1298).

157. The proposed capacity defence turned, once again, on Article 41 of the 2002 Finance Law, Decree 389 and the 2004 MEF Circular, which Christopher Clarke LJ considered in detail. He did so without the benefit of factual findings based on the evidence of expert witnesses, given the procedural context in which the issue had arisen, and as he noted, he had looked at the provisions relied upon "through English eyes" ([83]). Christopher Clarke LJ held as follows:

i) The purpose of Article 41 of the 2002 Finance Law was "to indicate the purpose for which the Ministry acts" but "the Article, itself, does not specify or limit the type of derivatives which may be approved, nor indicate that they must successfully contain the debt if they are to be valid" ([72]).

ii) While it was not clear what the phrase "containment of the costs of the debt" in Article 41 covered, it was not possible to read "containment" as meaning that, at the date of the swap contract, its predicted effect on the expiry of the bond to which it related was that the cost of the debt to Piedmont would be no more than the coupon on the bond (i.e. that there was no negative mark-to-market).

158. So far as Decree 389 was concerned, Christopher Clarke LJ observed that there was nothing in Decree 389 which, in the case of an interest rate swap with a collar, required that "the present value of the anticipated payments and receipts by each party over the life of the derivative is such that neither party is a net gainer" and nothing "in Decree 389 which requires the cap and floor costs or values to be evenly balanced" ([75]). Nor did the terms of the 2004 MEF Circular (which was "not a legislative instrument but sets out guidelines"), Christopher Clarke LJ noting at [75]:

> "The valuation of a floor or a cap is no exact science; and depends on a number of assumptions and/or complex mathematical formulae or models, of which there

are several, predicting what may be a long term future. If the validity of a derivative with a floor and a cap depends on an alignment of cap and floor values current at the date of the agreement – a question affording wide scope for argument - the result would appear unworkable."

159. While recognising that there appeared to be an arguable case of breach of Annex 3 of Regulation 11522 (given a decision of a Milan court to that effect) ([76]), he held that was not sufficient to justify setting aside the judgment. Given the circumstances in which the judgment had been entered, and the delay in applying to set it aside, "it would require a defence of some considerable cogency, based on pretty convincing evidence" to justify setting the default judgment aside, and the judge was entitled to take the view that this had not been made out.

160. The first trial of these issues came before Walker J in *Dexia Crediop S.p.A. v Comune di Prato* [2015] EWHC 1746 (Comm). In addition to the arguments relating to the 2002 Finance Law, Decree 389 and the 2004 MEF Circular, the defendant in that case also raised an argument by reference to Article 119 of the Italian Constitution and Law 350/2003. On the basis of the expert evidence before him, Walker J held as follows:

i) Article 119 was a provision "of a high order of generality" ([144]), and the concept of "indebtedness" was exhaustively defined by the list in Article 3 of Law 350/2003 ([144]). That list did not include derivatives and did not extend to the transactions in issue.

ii) The change in the scope of Article 3 which took effect from 1 January 2009 was not merely clarificatory of the position before that date ([156]).

iii) Article 41(2) of the 2002 Finance Law imposed a financial advantage requirement which applied to derivatives where there was a debt refinancing transaction which involved new debt. For this purpose, it was necessary to consider the effective cost of the refinanced debt taking into account the effect of any derivative which formed an integral part of a debt refinancing transaction. The requirement did not involve examination of a derivative transaction in isolation: the overall benefit of the whole debt refinancing transaction is what mattered for the purposes of Article 41.2. Although he said he did not need to decide the point, the Judge also said that he favoured Dexia's case that there was a fourth qualification to the application of Article 41(2) to derivatives, namely that the requirement does not involve taking account of either the initial MTM or the so-called "implicit costs" of the derivative, since they are not actual costs.

iv) Article 3 of Decree 389, as interpreted with the benefit of the 2004 MEF Circular, was not contravened because it imposed no requirement that, when a local authority purchased a collar, the MTM of the floor at inception had to be equal to the MTM of the cap at inception ([190]) and there was no contravention of Article 3.2(f) because an analysis of cashflows did not show "an increasing profile of the present values of single payment flows."

v) The statement in the 2004 MEF Circular that:

> "In the event of a variation in the underlying debt of a derivative instrument, for example because the debt has been renegotiated or converted, or because

it has reached an amount inferior to what was initially foreseen, the position in the derivative instrument can be readapted on the basis of conditions that do not determine a loss for the agency";

went "well beyond what is said in article 3.3" ([199]) and had not been the subject of Italian law evidence ([200]).

vi) There was no general prohibition on local authorities entering into speculative transactions under Italian law ([203]).

161. There was an appeal against Walker J: *Dexia Crediop SpA v Comune di Prato* [2017] EWCA Civ 428. The only capacity challenges maintained were those advanced under Article 119 of the Italian Constitution read with Article 3 of Law 250/2003, and a challenge to one swap under Article 41.2 of the 2002 Finance Law. The Judge's conclusions were upheld. So far as the conclusion on Article 119 is concerned, the Court held that the judge had been entitled to conclude that a decision of the Court of Appeal of Bologna in *Municipality of C* (clearly the Court of Appeal of Bologna in the *Cattolica* case), on which the comune had placed significant reliance, did not correctly state Italian law, holding at [63]:

> "The Court of Appeal of Bologna is, of course, not the highest Italian court with jurisdiction in administrative law matters. The task for the judge was to predict how the highest court would determine the matter if it came before it. In our judgment, the judge was plainly entitled to prefer the evidence of Professor Napalitano and conclude that the highest court would not follow the reasoning in *Municipality of C*. Neither expert supported its essential reasoning, which is indeed extremely vague, difficult to follow and devoid of any analysis of paragraph 17 or the 2009 amendment. Moreover, the 2009 amendment, to include premiums on derivatives, is striking. If swap transactions were a form of indebtedness already covered by paragraph 17, it is impossible to see why the amendment was a rational one to make."

As noted below, in 2020 the highest court on civil matters, the Supreme Court, upheld the decision of the Court of Appeal of Bologna.

162. So far as Article 41.2 is concerned, the Court of Appeal held:

i) The judge was entitled to accept Professor Napolitano's evidence as to the legislative purpose of Article 41.2 ([97]) and as to the requirement of "new debt" for Article 41.2 to apply ([99]), supported as this latter conclusion was by the Court of Appeal of Milan in the *Arosio* case.

ii) Even if Article 41.2 had applied to the swap in question, the judge was right in his (obiter) conclusion that a negative initial MTM was not to be taken into account when calculating financial advantage ([117]).

163. Legal developments in Italy have since given rise to a further round of Commercial Court decisions. These have involved jurisdiction challenges (*BNP Paribas SA v Trattamento Rifiuti Metropolitani SPA* [2018] EWHC 1670 (Comm), [2019] EWCA Civ 768), an application for negative declaratory relief by a bank (*BNP Paribas SA v Trattamento Rifiuti Metropolitani SPA* [2020] EWHC 2436 (Comm)) and an

application to lift an automatic stay of proceedings commenced by two banks for declaratory relief (*Bank of America Europe DAC v Citta Metropolitana di Milano* [2022] EWHC 1544 (Comm)).

164. Most significantly, on 12 October 2021, Cockerill J handed down judgment in *Busto*. Cockerill J had to consider many (but not all) of the issues raised in this case, including the meaning and effect of the *Cattolica* decision. Cockerill J rejected the comune's challenges to the validity and efficacy of the swaps transactions in issue in that case, and the Banks understandably placed considerable reliance on her decision.

165. The position so far as the status of the *Busto* judgment in this litigation is concerned is as follows:

   i) To the extent that the judgment determines issues of English law (and I include within that description issues as to the characterisation for English conflicts of law purposes of certain issues raised by reference to Italian law), the decision is not strictly binding on me. However, as Lord Neuberger observed in *Witters v Joyce (No 2)* [2016] UKSC 44, [9]:

      > "So far as the High Court is concerned, puisne judges are not technically bound by decisions of their peers, but they should generally follow a decision of a court of coordinate jurisdiction unless there is a powerful reason for not doing so."

   ii) To the extent that the judgment makes findings of fact on Italian law, the effect of s.4(2) of the Civil Evidence Act 1972 is that the judgment could have been rendered admissible in evidence for the purpose of proving the content of that law, in which case "the law of that country, territory or part with respect to that matter shall be taken to be in accordance with that finding or decision unless the contrary is proved". However, it is necessary for a party seeking to rely on s.4(2) to serve a notice of an intention to rely on the other judgment for this purpose. No such notice has been served, with the result that the findings as to the content of Italian law in *Busto* have no evidential status.

   iii) However, Mr Dhillon KC adopted the reasoning which had led Cockerill J to reach her conclusions as part of his case.

166. *Busto* is the only decision before this one which has had to engage with the *Cattolica* decision, which indisputably constitutes a highly significant development in the response of the Italian courts to the status of swaps contracts entered into by Italian local authorities. That has to be born in mind when considering findings of Italian law made by English courts in the Before *Cattolica* Era.

H THE *CATTOLICA DECISION*

The Legal Context

167. Understandably the decision of the Italian Supreme Court in *Cattolica* loomed large in the parties' submissions on the issues of capacity, and a detailed analysis of that case is required to determine Venice's arguments that it lacked capacity to enter into the

Transactions. Before doing so, it is helpful to consider the legal background to the decision.

168. The financial pressures which IRS transactions imposed on those whose who had entered into them (including local authorities) led to a renewed legal focus on the nature of such contracts, and attempts to explore the legal options which might be available to challenge this type of transaction. This involved the exploration of issues of both private (or civil) and public (or administrative law), albeit those separate lines of analysis became intertwined. For that reason, it is helpful briefly to summarise some of the legal theories in circulation when the *Cattolica* decision came to be determined.

169. First, there was the argument that IRS transactions were in the nature of gaming transactions and therefore unenforceable by virtue of Article 1933 of the Italian Civil Code (**ICC**) (which makes all gaming debts unenforceable). That was a challenging analysis in many respects, not least given the fact that Article 23.5 of Legislative Decree No 58 of 24 February 1998 had exempted derivative contracts in the context of investment services from the Article 1933 prohibition. However, by way of a development of that argument, the policy reasons for enforcing IRS transactions came under close scrutiny, as part of an attempt to confine the enforceability of these type of transactions to contracts which were perceived to serve that policy.

170. Second, there was the possibility of those who had entered into IRS transactions invoking investor protection legislation, having regard to the advice or information provided (or not provided) to them by the counterparty banks at the point of transacting. However, the remedies available for complaints about the information or advice provided pre-contractually would not lead to the nullity of the IRS, but at best provide the basis for claims for compensation which were perceived as less satisfactory. Further, in many cases, there was a risk that compensatory claims were time-barred. Finally, so far as local authorities were concerned, they had generally confirmed as part of the pre-contractual process that they were competent and experienced in investor transactions of this type.

171. However, those two themes – whether the nature of an IRS was such as to merit enforceability at law, and complaints about the level of advice and information provided by banks before entering into the IRS – have remained central to Italian legal analyses of the swaps crisis. So far as the first is concerned, that concern has been addressed by focussing on Articles 1322, 1325 and 1346 of the ICC:

i) Article 1322 provides that "(1) the parties can freely determine the content of the contract within the limits imposed by the law; (2) the parties can also enter into contracts of a type that do not have a specific regulation, provided that they are directed to the realisation of interests worthy of protection according to the legal system" (the requirement that the contract be directed to the realisation of interests worthy of protection being referred to as a requirement that the contract have a lawful cause or *causa*).

ii) Article 1325 provides that two essential elements of a contract are "the function" or *causa* and the "object" or *oggetto*.

iii) Article 1346 provides that "the object of a contract must be possible, lawful, determined or determinable".

172. The general requirement as a matter of Italian contract law for a contract to have a worthy *causa* or *oggetto* before it would be enforced was used to support a legal analysis whereby only swaps which were "rational bets" because the risks being run were known at the time of contracting were enforceable. That theory also accommodated complaints about informational asymmetry at the point of contracting as between the bank and its client, by requiring the risks being run to be identified *in the contract itself* (thereby, in effect, introducing not simply a requirement that information of a particular kind be made available to the counterparty at the point of contracting but also a requirement as to the form of IRS transactions as well). Anolli and Perrone refer to this development as:

> "the reconstruction according to which derivative contracts are a 'rational risk', *causally valid* only if, at the time of entering into it, the contract identifies the risk borne by the parties by means of certain indicators: the current market value (mark to market); the possible future scenarios of performance of the contract, with an estimate of the related probabilities; the costs, normally implicit, incurred by the client, from the contract. By refusing to protect 'a transaction characterised by risks unknown to one of the contracting parties and outside the scope of the agreement', the approach has in fact 'the characteristic of automatically entailing the complete nullity of most, if not all, of the derivatives in circulation which have been concluded without an agreement on the quantative and qualitative extent of the risks".

173. It would appear that the view that only IRS transactions which involved a 'rational bet' in this sense were enforceable gained support in Italian courts from 2013 onwards, including in decisions of the Court of Appeal of Milan of 18 September 2013, the Court of Appeal of Bologna of 11 March 2014 and a further decision of the Court of Appeal of Milan of 11 November 2015.

174. In the public law context, when dealing with IRS transactions entered into by local authorities, similar concerns (as to the worthiness of the social purpose of the IRS transaction and the knowledge available to the local authority at the point of contracting) were also explored, both by reference to the concepts of *causa* and *oggetto* but also by reference to the restrictions or controls on the ability of local authorities to enter into particular kinds of transactions, and in particular the restrictions on borrowing and in relation to the entry into derivative transactions imposed by the legislation and associated instruments outlined at [129] to [147] above.

175. In particular, local authorities argued that the entry into IRS transactions, either generally or with particular features, involved borrowing other than for investment purposes for the purposes of Article 119 of the Italian Constitution and/or were transactions which could only be approved by the city council of a local authority, and not by its executive board, under Article 42 of TUEL. By the time of the *Cattolica* decision, it would appear that inconsistent decisions had been reached on these issues by the regional Court of Auditors (which are administrative tribunals appointed to control public expenditure and which are the competent courts to determine the liability of public officials).

The *Cattolica* Litigation

176. Those arguments were also raised in the civil courts, including in proceedings which had been commenced by the Municipality of Cattolica before the Court of Bologna (No. 5244/2009) seeking a decision that the three swap transactions which it had entered into were null and void, and consequential relief. Two of those transactions had involved an upfront payment being made to the Municipality.

177. The Municipality failed before the Court of Bologna, who found that the swap contracts could not be considered a form of indebtedness, whether for the purposes of Article 119 of the Italian Constitution or the provisions of law (discussed at Section L below) in relation to the respective decision-making responsibilities of the city council or the executive board.

178. However, the Municipality succeeded before the Court of Appeal of Bologna, which handed down judgment on 11 March 2014. In summary, the Bologna Court of Appeal found as follows:

    i) The swap transactions required the approval of the city council under Article 42 of TUEL, and in the absence of such approval were void.

    ii) There had been a breach of Article 119(6) of the Italian Constitution because the swap transactions represented indebtedness (actual or potential) and the Municipality had not undertaken this indebtedness for the purpose of financing investment expenditure.

    iii) This was so for both the two transactions which included an upfront element and the third which did not, it not being significant so far as the former was concerned that the 2008 Decree which had stipulated that swap transactions involving an upfront payment were a form of indebtedness for the purpose of Article 119(6) of the Italian Constitution had only been passed and come into effect after the swaps had been entered into.

    iv) Moving from the law regulating the actions of public authorities to the law of contract generally, the swaps did not comply with Article 1346 of the ICC because the swap contracts did not contain a specific reference to the underlying loans nor an MTM valuation and therefore lacked the essential element of a worthy *causa* (adopting the “rational bet” analysis).

179. The bank sought to appeal that decision to the Supreme Court. On 23 October 2018, the First Division of the Supreme Court made an interlocutory order (**the Interlocutory Order**) referring the bank’s appeal to the First President (the President of the First Civil Division of the Supreme Court) to ask him to consider assigning the appeal to the Joint Divisions of the Supreme Court. That power falls to be exercised when an appeal involves issues of law of the greatest importance, or where single panels of the Supreme Court have given conflicting rulings on the same issue of law (which was not the case here). When the Supreme Court sits in Joint Divisions, it does so in a panel of nine judges, rather than the usual five, and the bench includes the First President.

180. In considering the weight to be attached to the decision of the Supreme Court in *Cattolica*, the reasons given in the Interlocutory Order for taking this course, and the issues which the Interlocutory Order identified as arising, are of significance.

181. The Interlocutory Order noted that the Bologna Court of Appeal had held that:

i) All three swaps constituted indebtedness because of their uncertain nature and violated Article 119(6) of the Italian Constitution because they had not been undertaken "to finance investment expenses".

ii) The decision to enter into the swaps could only be taken by the city council, by reason of Article 42 of TUEL.

iii) The upfront payments had not been specifically allocated to investment expenditure at the point of contracting, as required.

iv) The swaps lacked essential elements of an enforceable contract in the form of a worthy *causa* and/or an *oggetto* in failing to identify the underlying loan contracts in connection with which it was said that the swaps had been taken out.

v) The swaps lacked essential elements of an enforceable contract in the form of a worthy *causa* and/or an *oggetto* in failing to state the current MTM at the time of contracting.

182. The Interlocutory Order noted that all these conclusions were challenged by the bank on appeal, and that the first three were connected. Having briefly set out the relevant legislative and administrative decrees, the Interlocutory Order noted that there had been inconsistent decisions of the Courts of Auditors on the issue of whether entering into an IRS which included an upfront payment constituted the assumption of indebtedness, and between the decisions of various Courts of Auditors on the one hand, and observations in a decision of the Council of State on another, on the issue of whether an IRS transaction (at least in some circumstances) required the approval of the city council under Article 42 of TUEL. It suggested that the issues raised:

> "may be of particular importance, in the framework of Article 374 of the Code of Civil Procedure, paragraph 2: in addition to being of great importance, on a practical level, for the concrete effects that the solutions to be adopted may have in the framework of the litigations between financial intermediaries and local authorities on derivatives (litigations often involving large monetary flows), they relate to issues on which the Court of Auditors, in its various administrative and jurisdictional forms, and the Council of State have provided conflicting responses. The importance of the issues to be dealt with derive, therefore, from the framework of serious uncertainty that is handed over by the various bodies that have dealt with them during the administration of control, judicial verification of accounting liability and judicial examination of the legitimacy of the exercise of the local authority's self-redress power.
>
> The Panel, although obviously aware that in the dispute brought to its examination there are legal positions, not involved in the assessments made by the Court of Auditors and the Council of State, believes that the need to avoid, for the future, that the rulings made by the first section of the Supreme Court mark fluctuations on an issue, which is of fundamental importance for the interests of local authorities and banking and financial intermediaries, considering that this issue is already marked by the aforementioned disagreements. It is therefore considered

appropriate to refer the case to the First Chairman, for the eventual assignment to the Joint Sections."

183. There can be no doubt, therefore, that the Interlocutory Order envisaged that the first three issues, in particular, raised questions of fundamental legal and practical importance, on which a decision of the Joint Divisions of the Supreme Court would provide important guidance in the face of currently conflicting judicial decisions. I was referred by Mr Cox KC to Michael Livingstone, Pier Giuseppe Montari and Francesco Parisi, *The Italian Legal System: An Introduction* (2nd) (2015) which noted at [7.22]:

> "According to the traditional doctrine, judicial decisions are not a source of law. One way to put the proposition is to state that judicial decisions are not binding precedents in subsequent cases; another is to say that decisions of courts affect only the parties and have no effects erga omnes. However the matter is put, it is obvious that the traditional Italian view of precedent is an organic part of the traditional view of the legal process, with its emphasis on legislative supremacy and a sharp separation of powers. The judicial function is limited to the interpretation and application of the law. If a decision of a court is a precedent or is otherwise effective beyond the limits of the case, it is engaging in a function reserved to the legislator.
>
> This theory of the limits of the judicial process, like other aspects of the folklore of judicial interpretation, is in conflict with the facts in Italy ....
>
> There are other factors...that call the validity of the folklore into question. The Supreme Court of Cassation is the highest court of judicial, as distinguished from administrative and constitutional, jurisdiction. It is at the apex of that part of the Italian judiciary most like common law courts in function. Article 65 of the 1941 Law on the Judiciary places the obligation of assuring the "uniform interpretation of statutes" and the "unity of national law" on the Supreme Court of Cassation. At an earlier time there were five such courts, all on the same level of authority, and considerable disparity existed among their interpretations. A principal argument for a single such court was the desire for an authoritative final voice on the interpretation of the law, and the statute expressly confers that function on the Supreme Court of Cassation. Even though the decisions of that court are not "binding" in theory, few judges would knowingly adopt a different interpretation. They may not be bound, but the pressure to conform is irresistible."

184. I accept that description of the practical status of court decisions in the Italian legal system, which is supported by the evidence of Professor Domenichelli on this topic (which I accept) and consistent with the practical status of jurisprudence in other civilian systems. In particular, I accept the particular normative force which in practice attaches to decisions of the Supreme Court as "the highest court of judicial … jurisdiction". An even greater normative force attaches to decisions of that court when sitting in Joint Divisions: if a subsequent Supreme Court does not agree with the view expressed by the Joint Divisions on a point of law, it is not free to depart from it, but must refer the point back to the Joint Divisions.

The Supreme Court Decision

185. I can adopt Cockerill J's summary of the structure of the Supreme Court's judgment set out in *Busto,*([137]):

"The substantive part of the Supreme Court Judgment (under the heading Reasons for the Decision) consists of 10 sections. These provide in summary as follows:

i) Section 1 sets out the five grounds of appeal against the Court of Appeal judgment relied upon by the bank;

ii) Section 2 sets out the ground of the Municipality's conditional cross-appeal. That has no relevance to the issues in this action;

iii) Section 3 refers to the Interlocutory Order and the issues raised by it;

iv) Section 4 contains an analysis of the '*topic of derivatives'*, with a particular focus on the interest rate swap (IRS). The section of the judgment also describes certain market concepts, most significantly mark to market;

v) Section 5 of the judgment considers the function/purpose of a swap;

vi) Section 6 of the judgment addresses '*the validity of the contractual instrument that contains'* the swap;

vii) Section 7 of the judgment begins:

'After these necessary preliminary clarifications, we can proceed with examining the issue (which is the basis of the questions posed by the division that referred the matter to these Joint Divisions) relating to the execution of derivatives, swaps and IRSs by public entities in general and local entities in particular'

Section 7 of the judgment then goes on to address the constitutional and statutory framework that governs the entry into derivative contracts by Italian local authorities, explaining how that statutory framework has changed over time;

viii) Section 8 of the judgment begins by stating:

•

'*The Court notes that the aforementioned changes in the law, while turbulent and not always linear, make it possible to conclude that, even during the period that Article 41 of the 2002 Budget Law was in effect and, thus, until 2008 (the year the legislature imposed more stringent limits on entities' ability to enter into derivatives) the contractual power of local entities had clear limitations'*;

ix) What is being addressed at Section 9 of the Supreme Court's judgment is highly controversial between the parties and is a specific topic of expert evidence. It begins as follows (at paragraph 9):

‘*However, that does not fully solve the problem brought to the attention of these Joint Divisions, since we must – within the ambit of the path theoretically admissible – determine whether other limits exist on the lawfulness of those contractual types for the Public Administration’*.

[I would note that Cockerill J went onto hold that Section 9 was concerned with the general requirements of the Italian law of contract so far as derivative transactions are concerned, and in particular with the essential elements of an Italian law contract of *oggetto* and *causa* and there has been no challenge to that conclusion in these proceedings].

x) Section 10 of the judgment addresses the two remaining grounds of appeal. This section of the judgment is introduced by the court stating (at paragraph 10):

‘*However, that does not fully solve the problem brought to the attention of these Joint Divisions, because of the remaining grounds (1 and 2) of the appeal, which involve the problem of the indebtedness of public entities and the authority to decide in relation to the same*’".

186. The issues which arise as to the effect of the *Cattolica* judgment before me are as follows:

i) Does Section 8 of *Cattolica* hold that Italian local authorities lack capacity to enter into speculative derivative transactions, and, if so, was that decision correct as a matter of Italian law?

ii) Did Sections 8 and/or 10 of *Cattolica* hold that swaps were a form of indebtedness (whether for the purposes of Article 119 of the Italian Constitution or otherwise) and that local authorities did not have capacity to enter into them other than for the purpose of financing expenditure?

iii) Did Section 10 of *Cattolica* hold that all swap agreements, or only certain kinds of swap agreement, required approval by the City Council (and, if the latter, which kinds)? It is accepted that Section 10 of *Cattolica* held that at least certain kinds of swap required approval at City Council level.

iv) In the extent to which *Cattolica* held that swap agreements required approval by the City Council, was that decision correct as a matter of Italian law?

I THE SPECULATION ARGUMENT

What did *Cattolica* Decide?

187. This is a particularly difficult question. The Bologna Court of Appeal had not reached any conclusion expressly based on the speculative nature of the swaps in *Cattolica*, but rested its decision on its determination that the swap transactions in issue were a form of actual or potential indebtedness which had not been entered into for investment purposes. The Bologna Court of Appeal referred to the issue of speculation only in the context of the ground of appeal concerning the failure to refer in the swap contracts to the underlying loan transactions, that being necessary because “derivatives could only

be used for hedging purposes and not … merely speculative". Further, the Interlocutory Order had not expressly raised the issue of whether local authorities could enter into speculative derivative contracts, albeit it had, in the context of the indebtedness issue, suggested that "it would be appropriate to analyse whether, during the relevant period, the conclusion of derivative contracts by local authorities was permitted".

188. Mr Cox KC submitted that the effect of the Supreme Court's finding in Section 8 of *Cattolica* was that **all** derivatives were a form of indebtedness for Article 119(6) purposes, and that speculative derivatives fell foul of Article 119(6) because they were not (ex hypothesi) entered into for the purposes of funding investment expenditure. In support of that conclusion, Mr Cox KC points to the Supreme Court's reliance on the Constitutional Court Decision No 52/2010. If that argument is correct, then the Speculation Argument essentially folds into the Indebtedness Argument, and the specific issues arising on that interpretation of Section 8 of *Cattolica* which are addressed in that context at [248]-[254] below. That argument is undoubtedly tenable, but in the final analysis, I am not persuaded that it is correct.

189. The Constitutional Court Decision No 52/2010 involved a challenge brought by two Italian regional authorities to the restrictions on the power of local authorities to enter into IRS transactions introduced on a temporary basis by the 2008 Decree (see [146]):

i) One of the regions, Calabria, appears to have argued that Article 119(6) gave local authorities the constitutional right to borrow for investment purposes, and that the temporary prohibition on entering into IRS transactions would unlawfully restrict that right. It is not clear to me whether that argument was advanced on the basis that an IRS was itself a permitted form of indebtedness, or a necessary adjunct to permitted forms of indebtedness (e.g., to the taking out of long term loans at floating rates of interest).

ii) In response, the President of the Council of Ministers argued that the temporary prohibition was necessary to address an economic and financial crisis "largely caused also by the indiscriminate use of derivative financial instruments that have led to significant debt for public bodies" and that "the complaint of breach of Article 119 of the Constitution is also unfounded, 'it being clear that the provision criticised does not prohibit the use of debt for investment expenses, whatever the financial instrument used'".

iii) The Constitutional Court noted of derivative transactions that "on a functional level, as is well known, the transactions in question, in addition to having a hedging purpose, can also perform a speculative function, affecting the same causal structure of the contract, with consequent risks of insolvency linked to various factors connected above all to the overall performance of the market". It held that the temporary ban was necessary "to prevent, through the conclusion of highly random contracts, the finances of the institutions themselves from being subject to debt exposures that are very onerous".

iv) The Constitutional Court held that the 2008 Decree was not inconsistent with Article 119(6), the Court noting that "the last paragraph of Article 119 of the Constitution places a financial equilibrium constraint that is substantiated in allowing local authorities to resort to debt only to finance investment expenses", and that it was open to the state by legislation to define what constitutes

indebtedness and investment, including by determining on a temporary basis that IRS transactions "cannot be classified as investment activity" and "to prohibit, among other things on an interim basis, the use of these types of transaction that are objectively dangerous for the equilibrium of regional and local finance".

v) It is that finding which Mr Cox KC invites me to interpret as the court determining that all IRS transactions are a form of indebtedness for Article 119(6) purposes, with the state using the legislative power permitted to it by Article 119 to provide through the 2008 Decree that such transactions could not (for an temporary period at least) constitute debt incurred *for investment purposes*.

vi) However, it is unclear to me whether the Constitutional Court was intending to go that far, or simply answering Calabria's argument that the 2008 Decree unlawfully limited its Article 119(6) right to incur debt for investment purposes through the conclusion of IRS transactions with the repost "it is for the state through legislation to define what constitutes an investment, and they said that these transactions do not serve that purpose".

vii) In any event, as the state had the legislative power to define both what constituted indebtedness and what constituted investment for Article 119(6) purposes, the 2008 Decree is essentially self-defining – the prohibition or limitation it imposes will by definition establish the scope of Article 119(6) with effect from the date the 2008 Decree came into force. That makes it unlikely that the Constitutional Court was intending to determine on an *a priori* basis that independently and in advance of the 2008 Decree, all IRS transactions constituted a form of indebtedness for Article 119(6) purposes.

190. The second difficulty I have with Mr Cox KC's interpretation is that Section 10 of *Cattolica* is flatly inconsistent with the premise of that interpretation, namely that all IRS transactions constitute recourse to indebtedness for Article 119(6) purposes. I consider this further at [236]-[254] below, but for present purposes simply note that:

i) [10.1.3] held specifically in relation to IRS transactions involving an upfront that they constituted recourse to indebtedness:

> "Amounts received as an upfront constitute indebtedness for purposes of public accounting law and Article 119 of the Italian Constitution".

That conclusion in relation to a specific type of IRS transaction would be superfluous if the Supreme Court, in Section 8, had already held that all IRS transactions constituted recourse to indebtedness.

ii) More significantly, [10.1.4] expressly rejects the argument that all other IRS transactions also constitute recourse to indebtedness, suggesting that answering this question requires a consideration of each swap transaction "as a whole".

191. So, if Section 8 did not decide that all IRS transactions constituted recourse to indebtedness for Article 119(6) purposes, what did it decide?

192. In Section 7, the Supreme Court had reviewed the various legislative provisions regulating the power of local authorities to enter into IRS transactions, noting that "the

contractual power of local entities [sc. to enter into IRS transactions] had clear limitations" in the period after Article 41 of the 2002 Financial Law first gave local authorities the power to enter into IRS transactions.

193. In Section 8, the Supreme Court then identified, as one of those limitations on the contracting power of local authorities, the fact that the IRS had to be "financially cost effective, since entering into speculative derivatives was prohibited". That prohibition was said to be attributable in the first instance to Article 119(4) and (6) of the Italian Constitution. By way of a reminder:

i) Article 119(4) provided that "revenues deriving from the above mentioned sources shall enable Municipalities, Provinces, Metropolitan Cities and Regions to fully finance the public functions assigned to them", a provision which the Supreme Court held imposed the "constraint of financial balance".

ii) As will already be clear, Article 119(6) provided that local authorities "may have recourse to indebtedness only for the purpose of financing investment expenditures".

194. As I have mentioned, the Supreme Court relied on the Italian Constitutional Court Decision No 52/2010 in attributing a prohibition on local authorities entering into speculative derivatives to Articles 119(4) and (6). It is difficult to find direct support in the Constitutional Court Decision no 52/2010 for that conclusion. However, the Constitutional Court judgment does provide support for the conclusion that Article 119 imposes a "financial equilibrium constraint" on local authorities, and highlights the extent to which IRS transactions may prove to be incompatible with that restraint. While the reliance placed by the Supreme Court on the Constitutional Court decision might be said to read much into the latter judgment, I do not feel able to say it is not a tenable interpretation of a judgment which is clearly susceptible to more than one reading.

195. In any event, the Supreme Court supplemented its reliance on the Constitutional Court Decision No 52/2010 with its own reasoning:

i) The Supreme Court held that the "aleatory" nature of derivative contracts (as the difference between the amounts to be paid and received by a local authority under an IRS is uncertain, and exposed to market risk) was not compatible with "the fixed nature of expenditure commitments" (and presumably, therefore, prima facie inconsistent with the need to balance income and expenditure as envisaged by Article 119(4)).

ii) The Supreme Court's reference to Article 119(6) in this context is less clear. The Supreme Court had yet to address the issue of whether entering into an IRS constitutes the assumption of indebtedness, and in due course it concluded that not all IRS transactions constituted indebtedness ([10.1.4]). However, the Supreme Court may have had in mind that the matching of borrowing to (investment) expenditure in Article 119(6) was a further example of the "constraint of financial balance".

iii) That would prima facie lead to the conclusion that local authorities could not enter into *any* derivative transactions, because they are all aleatory. However, that

conclusion cannot be reconciled with the specific legislative provisions the Supreme Court had reviewed at [7.1.1], [7.1.3], [7.1.5] and [7.1.6] which permitted local authorities to enter into derivative transactions in certain circumstances. The Supreme Court reconciled those provisions by treating them as specific permissions operating as exceptions from a general prohibition on local authorities entering into derivative transactions ([8.2]: "we must conclude that the law provisions examined above … only allowed what, normally, would be prohibited, with the result that those provisions were, above all, exceptional and had to be narrowly interpreted").

196. While the reasoning in the decision may not appear entirely satisfactory, the court's conclusion at [8.3] based on the "legal and axiological framework" it had set out is clear enough:

i) A public authority had contractual capacity to conclude derivative contracts until the 2013 Finance Law came into effect ([147]).

ii) However, only in the case of a hedging (and not a speculative) derivative "could be a local authority be said to have capacity to enter into them".

It is to be noted that it is only in [8.3] of the Supreme Court decision in *Cattolica* that (two) express references to capacity are to be found.

197. The Banks argue that, properly interpreted, these paragraphs of *Cattolica* did not involve a finding that, as a matter of Italian law before an Italian court, a local authority lacked the substantive power or legal ability to enter into a valid speculative derivative transaction, but only that a local authority was prohibited from entering into such transactions. It should be noted that, in a case concerned with transactions governed by Italian law, the distinction between those categorisations was likely to be of far lesser moment than it might prove to be in the present context. While what ultimately matters in this regard is how English law categorises the position (which I discuss below), I am satisfied that the effect of the Supreme Court's decision was that, as a matter of Italian law, local authorities lacked the substantive power to enter into speculative derivative contracts rather than that they were acting illegally in doing so:

i) The Supreme Court's summary of the statutory framework referred to various enactments making it "possible" for local authorities to enter into particular derivative transactions (e.g. [7.1.1]), or giving them "authority" to do so ([7.1.3]), or which "precluded" local authorities from entering into such transactions ([7.3]).

ii) The various statutory restrictions were described in [8] as "limits of entities' ability to enter into derivatives" and the Supreme Court introduced the discussion of speculative derivatives which followed as showing that "the contractual power of local entities had clear limitations".

iii) While the language of "prohibition" can be found in [8.1] and [8.2] in relation to speculative derivatives, that was linked to Articles 119(4) and (6) of the Constitution. As I explain at [270]-[271] below, I am satisfied that Article 119(6) is a limit on the substantive power of a local authority, and while the Supreme Court may not have been directly applying Article 119(6) at this stage of its

judgment, the significant reliance placed on Article 119(6) suggests that the Supreme Court was dealing with a limitation on local authorities' powers of the same kind.

iv) When addressing the civil law restrictions relating to *oggetto* and *causa* in Section 9, the Supreme Court referred back to its Section 8 distinction between speculative and hedging derivatives in language which distinguished between the *ability* of local authorities to enter into hedging derivatives, and their ability to "usefully and effectively do so":

> "In regard to derivative contracts entered into by Italian Municipalities based on the laws in effect until 2014 … and the distinction between hedging and speculative derivatives based on the criterion of the different degree of risk of each of them, although local authorities *could enter into the former* with qualified financial intermediaries, local entities *could usefully and effectively do so* only if the contractual object … could be precisely measured/determined".

That passage appears to be drawing a distinction between the power to contract at all (in relation to the speculative/hedging distinction, with local authorities having power to enter into derivatives of the latter kind but not the former), and the enforceability of the transaction where there was such a power (having regard to the requirement for a legitimate *oggetto*).

198. The Banks also argued that, if the Supreme Court did hold that local authorities had no substantive power to enter into speculative derivative contracts, its decision was wrong as a matter of Italian law, relying in this regard on Professor Torchia's evidence. The effect of that evidence was as follows:

i) As a matter of Italian law (Article 11 of the ICC and Article 1(1 *bis*) of the Law of Administrative Procedure), a local authority has the same capacity to contract as other legal and natural persons, save to the extent that its capacity is expressly restricted by law.

ii) There is no legislation which removes the contractual power of Italian local authorities to enter into speculative derivative contracts.

iii) The Supreme Court was in error in purporting to derive a limitation on the contracting power of local authorities so far as speculative derivatives are concerned from the Constitutional Court Decision No 52/2010.

iv) Article 119(6) of the Italian Constitution does not limit the capacity of a local authority, but renders any transaction which does not comply with that provision void.

v) The provisions of the 2008 Decree and the 2013 Finance Law did not themselves limit the contractual capacity of local authorities, because they allowed the local authority (but not its counterparty) to enforce such a transaction.

199. Those objections fall into two categories – an objection that there was no restriction on the ability of local authorities to enter into speculative derivatives as a matter of Italian

law; and an objection that such restrictions as there were in relation to a local authority's power to enter into contracts of a particular kind were in the nature of prohibitions rather than restrictions on the local authority's power to contract.

200. As to the former,

i) I have noted that the Supreme Court's decision involved reading much into Constitutional Court judgment No 52/2010. However, for the reasons I have set out at [194] above, I accept that there are aspects of that decision which can be read as providing support for the Supreme Court's analysis, and I am not persuaded that the Supreme Court's interpretation is untenable, nor does its analysis rest entirely on its reading of Decision No 52/2010 in any event.

ii) While I accept Professor Torchia's evidence that, as a matter of Italian law, a limitation on the substantive power of a local authority to enter into a contract of a particular type must be found in legislation, the Supreme Court purported to found that limitation in its interpretation of Articles 119(4) and (6), and the limitations of the "enabling" legislation it summarised in Section 7 of the judgment.

iii) The Supreme Court's interpretation does not appear to have involved the direct application of those provisions, or a process of textual interpretation in a conventional sense, but reliance on those provisions to identify a principle which the Supreme Court then applied. It was, undoubtedly, the Supreme Court itself, rather than the language of the legislative enactments, which did the "heavy lifting" in formulating this restriction. Indeed, Italian academics have noted that the contribution of case law on the issue of local authority swap transactions "is to be appreciated on an objective level, as a particularly 'creative' and decisive intervention in the development of the matter" (AA Dolmetta cited in Mario Anolli and Andrea Perrone, "Italian Case Law on Derivative Contracts: An Interdisciplinary Analysis"(2020) III(II) Revista di Diritto Bancario 195). The Berti Article, 37 described the Supreme Court as "drawing from the system, in an interpretative way, the guiding principle that directs the administrative action" (which reflects the fact that, as Mr Dhillon KC submitted, there was no conventional process of ascertaining and directly applying the text of the relevant enactments).

iv) However, applying the deference to which a decision of the Joint Divisions of the most senior civil court in Italy is entitled (see [125] above), I do not feel able to conclude that the decision was not open to the Supreme Court as a matter of Italian law or that it does not represent Italian law as matters stand.

v) Further, there have been four subsequent decisions of the Italian Supreme Court which have applied *Cattolica* (Decisions Nos 2157/2021, 21830/2021, 24014/2021 and 8603/2022). While these decisions were all concerned with that part of the *Cattolica* decision concerned with Articles 1322, 1325 and 1346 of the ICC (and hence *oggetto* and *causa*), those were, if anything, even more controversial elements of the *Cattolica* decision, and there are some similarities between aspects of the reasoning in Section 9 of *Cattolica* and that in Section 8. There is nothing to suggest that the Italian Courts are experiencing any "buyer's

remorse" at the very significant changes in Italian law effected by *Cattolica* so far as IRS transactions are concerned.

201. So far as the second issue is concerned, what ultimately matters is the proper characterisation of the provision as a matter of English conflicts of law analysis (see [273] below). The fact that Italian law does not recognise a doctrine of *nec ultra vires* or that there are circumstances in which a transaction may nonetheless be enforceable notwithstanding the restriction on a local authority entering into a transaction of a particular type are not in themselves determinative in that analysis. However:

i) The heart of the Banks' submissions on this issue (to quote from paragraph 168 of their opening) is that there is a "fundamental distinction between a prohibition which renders an act unlawful such that the law provides for a specific consequence (e.g. providing that the resulting act shall be void) ... and a restriction placed on the power of an entity to do an act", with Article 119(6) being a provision of the former kind.

ii) However, and with respect, that distinction of such central importance to English lawyers proved rather more elusive in the Italian legal materials.

iii) Thus, when identifying exceptions to the general capacity of public bodies to undertake private law acts such as entering into contracts, Professor Torchia, Professor Gentili and the underlying materials generally defined the exception to general capacity as something which would arise from a "prohibition". Thus, Professor Torchia in her first report stated that "public bodies have a general capacity to acquire legal rights and obligations, unless there is an express prohibition by law" ([14.2]) and referred to "the general capacity of public authorities to enter any kind of contract – unless there is an explicit prohibition set by law" ([14.4]). Professor Gentili in his report also referred to the general capacity of public authorities unless "there is an explicit prohibition set by law" ([5.75]).

iv) I was referred to Supreme Court Decision No 11656 of 12 May 2008 which stated "both public legal entities and private legal entities have the same capacity, so that the public administration can enter private law contracts *if there is not a specific prohibition"* (emphasis added). Further, Council of State Decision No 1156/2010 referred to the capacity of a public administration to enter into contracts only existing when "exercised in accordance with the procedures defined by the legislature and, in the species, by the express will of the legislature" ([6.7.1] and to "lack of capacity of the public [authority]" depending on "the violation of rules dictated in the public interest concerning, ultimately, the economic public order". While that statement was made in the context of a failure to comply with public tender rules it is equally (or even more) apposite as a means of referring to a failure to comply with Article 119(6) of the Constitution.

v) While the 2013 Finance Law permitted public authorities to enforce prohibited swaps, the effect of contravention of Article 119(6) of the Constitution prior to that date was the transactions were void and unenforceable for both parties.

When is a Derivative Speculative?

202. It is common ground that while the Italian legal or regulatory regime treats the question of whether a derivative is a hedge or a speculative transaction as significant for certain purposes, Italian law does not provide a definition of what constitutes a speculative derivative. Indeed, the lack of any clear definition was one reason why the Banks submitted that there could be no limit on a local authority's ability to enter into speculative derivative transactions.

203. The evidence as to what made a derivative transaction a hedge, or speculative, comprised:

i) evidence of Italian law (both from the experts and from Italian case law);

ii) reference (on Venice's part) to English case law addressing this topic under other legal systems; and

iii) evidence from the two market practitioners as to their understanding.

204. As the issue which arises for determination concerns a restriction on the ability, as a matter of Italian law, of Italian local authorities to enter into a transaction of a particular type, I found the evidence in the first category of the greatest assistance.

The Italian Law Evidence

205. It was Professor Gentili's evidence that, by the time of the Transactions, the concept of "hedging" had "*de facto* achieved a specific and technical and legal meaning under Italian law", namely a derivative which satisfied the test set out in the CONSOB Determination (see [133]), and that it could be inferred that a derivative transaction which did not satisfy those requirements was speculative.

206. The CONSOB Determination advised that a derivative would be considered a hedging transaction (and implicitly not a speculative transaction) if three conditions were satisfied:

i) the transaction is explicitly carried out to reduce the risks connected with the underlying instrument;

ii) there is a "high correlation" between the technical and financial characteristics of the underlying instrument (i.e., maturity, interest rate, etc.) and those of the derivative transaction; and

iii) there are procedures and internal controls within the intermediary which are sufficient to make sure that the above conditions are satisfied.

207. In Professor Gentili's view, that third element (which essentially concerned the records kept in relation to the conclusion of the transaction rather than anything intrinsic to the transaction itself) was not relevant in this regard. I agree with that assessment, although no doubt the absence of such records might make it difficult for a contracting party to persuade an interested observer that the transaction in question was a hedge.

208. I accept that the CONSOB Determination is of assistance when determining whether or not a derivative is a hedge. It has been relied upon in a number of Italian court decisions (including the Supreme Court in Decision No. 19013/2017 and the Court of Appeal of

Milan in Decision No 921/2021), and in determinations by the Italian Arbiter for Financial Disputes (in Decision No 5017 of 25 January 2022).

209. However, it is clearly not exhaustive. It was issued in 1999 to deal with a specific query raised by a private company in the context of various articles of CONSOB Regulation No 11522/98:

i) Article 28.3 (the obligation of authorised intermediaries to inform investors as soon as derivative instruments entered into "for purposes other than hedging" have generated a particular level of actual or potential loss).

ii) Article 37.1(d) (a management contract had to indicate whether derivative financial instruments could be used for purposes other than hedging the risks associated with the positions held under management).

iii) Article 43.5 (permitting authorised intermediaries to carry out derivative financial instruments only when certain conditions were met, including, in the case of options, derivatives and short sales, that they were traded on regulated markets "unless the contracts are concluded for the purpose of hedging the risks associated with positions held under management").

The CONSOB Determination was not, therefore, formulated with the specific considerations regulating local authority finance in mind, but by reference to the services being provided by financial intermediaries or asset managers. Nor did it engage with more nuanced questions such as the status of a swap which (in part at least) is entered into for hedging purposes, but the parameters of which are structured for the purpose of eliminating an exposure such as a negative MTM on an existing transaction which the contracting party wishes to close out. Finally, there are many Italian court decisions which have addressed the issue of whether a derivative was hedging or speculative in nature without referring to the CONSOB Determination or applying the three-stage test (for example those referred to in Professor Alibrandi's third report, [12]).

210. I also accept Professor Gentili's evidence that the issue of whether an IRS transaction is in the nature of a hedge or speculative must be judged *ex ante* rather than in hindsight. While good fences may make good neighbours, it is not the case that bad hedges make void contracts. That conclusion is supported by three decisions to which Professor Gentili referred, of the Court of Appeal of Milan in Decision No 921/2021 and the Supreme Court in Decisions No 18724/2018 and No 24014/2021.

211. Professor Alibrandi sought to draw her test for the distinction between a speculative derivative and a hedge from the *Cattolica* decision. It was her evidence that "a hedging derivative causes a reduction of the underlying risk borne by a protection whereas a speculative derivative gives rise to a new risk or causes an increase of the underlying one". However:

i) Any hedge will necessarily involve a risk that the actual rate may move in such a way that the protection buyer will be worse off than if they had not brought the protection, as well as being better off. A vanilla IRS in which the protection buyer who has a variable interest rate exposure purchases an IRS to hedge that exposure by agreeing to pay a fixed rate to a bank in return for receiving interest at the

variable rate runs the risk that the fixed rate paid will exceed the variable rate received.

ii) It was no doubt for that reason that the Supreme Court in *Cattolica* was at pains to point out that both hedging and speculative derivatives involved the assumption of risk by a local authority, albeit (in the Supreme Court's determination) different degrees of risk: [8.2], [8.3] and [9.8].

212. In my assessment, Professor Alibrandi was on surer ground in relying on judicial determinations on this issue in other cases, an analysis which was supplemented by additional authorities placed before the court to similar effect:

i) A number of these decisions found (not surprisingly) that a derivative contract entered into when there was no underlying risk to hedge was speculative (see Court of Turin, 21 October 2021 Decision No 4685, Court of Florence, 5 June 2012 and Court of Lucera, 26 April 2021).

ii) A significant discrepancy between the notional amount, maturity date, exchanged interest rate or cash flows of the derivative and the underlying risk has also been relied upon to support the conclusion that a derivative was speculative: e.g. the Court of Cassation Decision No. 19013/2017, the Court of Rome, 8 January 2016, Decision No. 212, the Court of Novara, 24 July 2012, Decision No. 569, and the Court of Turin, 21 October 2021, Decision No. 4685. Those cases reflect the second stage of the test propounded in the CONSOB Determination of the need for a "high correlation" between the technical and financial characteristics of the underlying instrument and those of the derivative transaction.

iii) A decision of the Court of Auditors of the Lazio Region of 12 April 2022 (No 42), which was added to the trial bundle after the expert witnesses had given evidence, held a swap to be speculative where the local authority, whose own borrowings were on a fixed rate basis for 86.5% of its underlying debt, agreed to receive a fixed rate from the bank in return for paying the bank interest in two tranches calculated by reference to two structured variable rates. The Court of Auditors held that this could not be a hedge because there was "no risk to be hedged" (because the vast majority of the authority's borrowing was at a fixed rate), but was "a mere financial speculation, at high risk of loses" (the authority hoping that market movements would be such that the interest payable to the bank would be less than the fixed rate being received). Venice also relied on another decision added to the trial bundle after the expert evidence (a decision of the Court of Venice No 696/2022) to similar effect so far as the 2005 swap in that case is concerned.

iv) A decision of the Court of Appeal of Milan in Decision No 2393/2020 involved a "collar" swap in which the MTM of the cap at the date of the swap was much lower than the MTM of the floor. The Court of Appeal held that this was a speculative derivative. In reaching that conclusion, the Court of Appeal relied on Article 3, paragraph 2(d) of Ministerial Decree 389/2003 (see [136]) and the 2004 MEF Circular ([140]), stating that it permitted a local authority to purchase a collar, not to sell one, and it was held that if the MTM of the floor in favour of the bank was significantly greater than the MTM of the cap, it was the local

authority which was purporting to "sell" a protection which was an inherently speculative transaction. The Court of Appeal concluded:

> "An invalidity that - due to its speculative characteristics - must therefore affect the entire contract, and not only the part that concerned the imbalance between the MTM of the cap option and the MTM of the floor option, as also argued in the alternative by the appellant and, in the opinion of this Court, without foundation."

v) A (pre-*Cattolica*) decision of the Court of Orvieto of 12 April 2012, applying a "prima facie likelihood of success" (*fumus boni iuris*) test in the context of an application for an injunction, found the derivative contract in that case prima facie speculative because the terms of the contract had been structured to absorb the negative MTM on prior swap transactions. The Court observed:

> "The reason that drives the said authority to renegotiate the derivative contract is to stop excessive and out-of-control losses arising out of the accrual of negative differentials. As a consequence, the derivative contract as renegotiated appears to be less and less connected to its original reason (the hedging of a material risk), getting dangerously close to purposes that can properly defined as speculative … Local authorities are only allowed to underwrite derivative investments with hedging purposes (Article 3 of Ministerial Decree No 389/2003 and Article 41 of law No 448/2001)".

vi) The Court of Turin of 21 October 2021 in Decision No 4685/2021 was a non-local authority case in which the intermediary had suggested to its client that a proposed swap transaction was a hedge. The "hedge" in question replaced a previous swap transaction with a negative MTM, which was rolled into the new structure. In considering whether the new swap was a hedge, the Court considered and applied the CONSOB Determination. With specified reference to the negative MTM rolled over from the previous swap, the Court noted

> "Renegotiation can procrastinate the matured loss over time, dilute it (if e.g. the duration of the contract is extended compared to the original swap) and, to the limit, makes the exposure in client derivatives assume a highly speculative connotation, regardless of the coverage function of the first contract, to the extent the contract is renegotiated, to resorb the accrued loss, contains features (notional, duration and parameters) without 'high correlation' to existing exposure".

vii) By contrast, the Supreme Court in Decision No 21830/2021 held that a vanilla IRS swap transaction (the purchaser paying a fixed interest rate in an amount aligned with its underlying borrowing in return for receiving a floating rate on the same amount) was a hedge, and not a speculative transaction. In addition to the close alignment of the IRS with the terms of the underlying borrowing (cf, the second element of the CONSOB Determination), the court noted the "alignment between the financial parameters included in the derivative contract and the forecasts of the trend of interest rates for future years covered by the IRS (so-called forward rate curve)". I would note that if the terms of the derivative have been structured not simply to reflect current expectations of the potential for future interest rate movements, but "off market" in an effort to cover the cost

involved in covering a negative MTM on a transaction which is to be closed out, that "alignment" will necessarily be absent.

213. On this last topic, it is to be noted that one of the swaps in issue in *Cattolica* had been structured so as to absorb a negative MTM under a preceding swap transaction, the First Division noting in the Interlocutory Order that upfront payments were "obviously useful for management of current expenses or for settlement of previous debt exposures (as happened in the case of second transaction in question, where the disbursement was almost entirely used to cover the losses previously incurred)".

The English Authorities

214. Next, Mr Cox KC relied on various English authorities which have considered, in the context of foreign law restrictions on the ability of legal persons to enter into particular types of transactions, whether particular derivatives were speculative. In *Busto*, Cockerill J observed of an attempt to rely on English decisions applying English law in this context at [289(ii)] that:

> "the case on the dividing line between hedging and speculation is in this case one of Italian Law. It is impermissible for me to impose English Law concepts of hedging as it would be to impose an English Law understanding of the capacity/validity divide".

215. I share Cockerill J's view as to the limits on the utility of referring to decisions reached when applying the law of other jurisdictions to the issues which arise under Italian law. For that reason, I have placed only limited weight on the English decisions on which Mr Cox KC relied. However, it is of interest to note that many of the factors highlighted in the Italian case law are echoed in the English cases, and that in each of those cases, the courts recognised and applied a limit on the contracting power of a corporation to enter into speculative derivatives without the benefit of a statutory or judicial definition of what made a derivative speculative.

216. In *Credit Suisse International v Stichting Vestia Groep* [2014] EWHC 3103 (Comm), the issue arose in relation to the capacity of a housing association incorporated under Dutch law. At [217], Andrew Smith J found that hedging encompasses:

> "Instruments that reduce, as well as instruments that eliminate, exposure to risks from borrowing liabilities. The defining characteristic of hedging is that it eliminates or reduces an exposure to some market risk or risks: see the definition of 'hedging' published by ISDA, 'A trading strategy which is designed to reduce or mitigate risk. As I understand what constitutes 'hedging', Vestia would properly be said to have 'hedged' a risk of loss if they entered into a transaction that reduced or limited it, either in the sense of limiting the amount of the overall loss that Vestia potentially face from market movement (or in other circumstances) or in that the hedge would protect them from loss only in particular circumstances."

In respect of certain transactions, the Judge concluded that they were speculative as a whole even though they included elements which would operate as a hedge in certain circumstances.

217. In *UBS AG v Kommunale Wasserwerke Leipzig Gmb*H [2014] EWHC 3615 (Comm), [159], Males J held that a swap which materially increased a risk to which the purchaser was already exposed was speculative.

218. Finally, Mr Cox KC referred to the consideration of the distinction between hedging and speculation by an arbitral tribunal comprising Lord Millett, Mr Michael Hwang SC and Mr VV Veeder QC when considering the contracting powers of a corporation incorporated under Sri Lankan law. The tribunal's analysis is set out and discussed by a judgment of the Court of Appeal in *Standard Chartered Bank v Ceylon Petroleum Corp* [2012] EWCA Civ 1094, [9]-[12]. The tribunal held that:

    i) hedging involved reducing existing exposures to a particular risk, whereas speculation involved the assumption of a new risk for the purpose of financial gain independently of any other risk;

    ii) hedging involved protection against future adverse price movements, and the use of derivative instruments to raise money to offset the effect of existing high prices was necessarily speculative; and

    iii) the derivatives in question gave the purchaser a small return unless the market collapsed, in which case it would suffer catastrophic losses, and were therefore speculative because they involved the purchaser "acting as insurer, not as insured".

The Evidence of Market Participants

219. Venice obtained permission to call expert evidence on the issue of "how would market participants in 2007 have determined whether a derivative contract was speculative?" However, the answer to that question would necessarily depend on the context in which it was asked. If the question had been "how would markets participants in 2007 have determined whether a derivative contract was speculative for the purposes of determining whether an Italian law restriction on the contracting power of local authorities was engaged?", the answer would almost certainly have been "I would have asked an Italian lawyer".

220. In any event, I was not persuaded on the evidence that this was a question which market participants would have asked themselves in 2007 in any context. It was the evidence of Mr Malik, who had over 20 years' experience of trading, structuring, risk-managing and advising on derivatives, that he had never had cause to answer that question in any context. Ms Bowie also accepted in cross-examination that the answer to that question was context-dependent (including by reference to the legal and regulatory framework). Neither expert pointed to any market standards, definitions or publications which had informed their evidence. In the final analysis, I was not persuaded that either expert was doing (or was able to do) anything more than offering their own subjective view, and a view which reflected their de novo analysis having been asked to consider the issue in the context of this litigation, rather than one which drew on practical experience of addressing the same issue in their professional lives.

221. In these circumstances, while I was assisted by the market participants' evidence in relation to pricing, valuation and their probabilistic evaluations of elements of the Transactions, I have not (with respect) been assisted by their evidence as to what and

what does not constitute speculation for the purposes of the Italian law question I have to decide.

Conclusion

222. I will not attempt to formulate a definitive test of what makes a derivative speculative as a matter of Italian law, when the Supreme Court in *Cattolica* did not itself do so, and when it remains possible to apply a restriction by reference to that criterion without doing so ([215]). The Italian case law identifies a number of indicia or features which, either individually or in combination, may have the effect that a derivative is a hedging transaction, or a speculative transaction (many of which, as Mr Cox KC submitted, are reflected in English case law on the same topic).

223. In *Jacobellis v Ohio* 378 U.S. 184, 197 (1964), Justice Potter Stewart famously observed of the topic of obscenity, "I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it". The time has come to see if speculation is to be seen in the Transactions.

Were the Transactions Speculative?

224. Over the course of the trial, there was a considerable amount of skirmishing around the fringes of this issue – debates as to whether it was being said that any transaction involving an element of risk or uncertainty as to the payments which would be made on either side was speculative (for example insurance contracts or floating interest rate loans). However, commendably, in closing Mr Cox KC cut right to the heart of the matter so far as this particular case was concerned – the fact that the terms of the swap had been structured so as to cover amounts which the Banks had to pay to Bear Stearns to close out the Bear Stearns IRS.

225. In my determination, the essential facts relating to Venice's decision to enter into the Transactions were as follows:

    i) Venice wanted to restructure the Rialto Bond (in particular by lengthening the repayment date by 15 years) in order to realise savings and "free-up" its budget, and also to obtain protection through an IRS against the risk of a significant increase in interest rates over the extended duration of the Rialto Bond.

    ii) The Bear Stearns IRS reflected the original tenor of the Rialto Bond, and by the end of 2007, the Bear Stearns IRS had a significant negative MTM so far as Venice was concerned of €7.5m. Bear Stearns was also entitled to additional fees and costs as the price of unwinding the Bear Stearns IRS.

    iii) Any restructuring of Venice's IRS protection to reflect its desire to extend the repayment date of the Rialto Bond required Venice to address the Bear Stearns IRS and the negative MTM on it. That could have been done (i) by making a payment to Bear Stearns to unwind the Bear Stearns IRS and entering into a new and independent transaction with Bear Stearns or someone else; (ii) re-negotiating the duration of the Bear Stearns IRS on a basis which rolled over the negative MTM or embedded it in an adjustment of the terms of the new swap; or (iii) entering into an IRS with another bank or banks who would themselves make the

payment necessary to close out the Bear Stearns IRS, and recover the cost of doing so through the terms of the new swap.

iv) As I have explained at [82]-[88] above, I am satisfied that by the time it issued the tender letters, Venice had decided to replace the Bear Stearns IRS, and that it wished to do so without having to meet the wind-up cost in 2007. A proposal which rolled that wind-up cost into the terms of the new derivative was attractive to Venice. As a result, Venice chose the third option, with the Banks paying Bear Stearns a total of c €8m to effect the unwinding of the Bear Stearns IRS.

v) The result was that the Transactions were entered into in part for the purpose of providing protection against a significant increase in interest rates during the extended period of the Rialto Bond. The many statements made by Venice to that effect – for example in Resolution 129, Executive Resolution 3561 and in the representations made at Part 5 paragraph 3(ii)(B) of the Schedules to the Venice Master Agreement and otherwise – were, to that extent, correct.

vi) However, that is not the whole story. In doing so, Venice also wanted to provide for its exposure in respect of the negative MTM under the Bear Stearns IRS, and to do so through the floor and cap in the Transactions. Venice was also attracted by the fact that the terms offered by the Banks would provide a short-term net cashflow benefit (in the first half of 2008).

226. The impact on the terms of the Transactions of structuring the collar to cover the costs of winding up the Bear Stearns IRS was considerable:

i) This was the principal reason why the Transactions had a very significant MTM in the Banks' favour from the outset (a combined positive Day 1 MTM of c €10.5m in the Banks' favour).

ii) This was the principal reason why the value to the Banks of the interest rate floor (estimated by the experts at between €12.4m and €12.974m) was more than five times the value to Venice of the cap (estimated by the experts at between €1.7m and €2.4m).

iii) This was the principal reason why, on the basis of a Day 1 statistical probabilistic calculation, the probability of Venice losing money on the Transactions was high:

a) On Ms Bowie's calculations, the probability of a negative pay-off for Venice under the Transactions was between 77.1 and 78.7% (depending on whether or not the calculation is performed on an "absolute" basis or on a basis which discounts future cashflows to present value), whereas if the amount paid to wind up the Bear Stearns IRS is removed from the calculation, the figure is 59.3%.

b) Mr Malik did not put forward his own calculation of the probability of a negative pay-off for Venice under the Transactions or challenge Ms Bowie's calculation of 78.7%, saying that in his experience banks did not produce such calculations and he did not consider that they had utility for customers. He did perform a calculation removing the amount paid to wind down the Bear Stearns IRS from Ms Bowie's calculation and arrived at a

figure of 57.3%. The Banks' closing submissions did not challenge Ms Bowie's figure, but noted that "stripping out" the Bear Stearns IRS wind up cost reduced that figure to 57.3% on Mr Malik's figures.

iv) On Mr Malik's evidence, it led to the floor being between 80 and 100 basis points higher than it would otherwise have been.

v) On Ms Bowie's calculations, it meant that the Transactions involved a modelled "realistic worse case" outcome for Venice of the order of €70.6m (modelling to a 95% confidence level). Mr Malik gave evidence that the MTM distribution analysis which Ms Bowie had performed would be of limited use to customers, and that banks did not provide MTM distribution analyses to customers. He did accept, however, that the effect of including the large negative MTM from the Bear Stearns IRS was to lower the probability of the Transactions being positive in the future.

227. In my view, Mr Cox KC was right to submit that, in addressing the cost of winding up the Bear Stearns IRS through the terms of the Transactions, Venice was obtaining the possibility that interest rate movements during the life of the Transactions would be such that Venice would not have to pay a sum equivalent to the wind-up cost, but in return, was running the risk that interest rate movements during the life of the Transactions would be such as to lead to it paying a great deal more.

228. The decision to address the cost of winding-up the Bear Stearns IRS within the terms of the Transactions had other consequences:

i) It meant that the terms of the Transactions were in material and financially significant respects (the level of floor and cap) not determined by the terms of the Rialto Bond (although I accept that important terms were so determined – the Notional Amounts, the amortisation rate, the maturity date and the interest rate received by Venice from the Banks).

ii) It meant that the minimum interest rate which Venice was committing to pay was not aligned with the forward rate curve at the time of contracting.

iii) It involved the assumption by Venice of a new and significant risk (viz of having to pay interest to the Banks at the floor level while receiving interest payments at a much lower rate) which did not arise under the Rialto Bond. While the character of the Transactions must be determined *ex ante*, some indication of the degree of risk run can be seen in the fact that by the end of the most recent payment period (24 June 2022), Venice had made total payments to the Banks of €70,995,695.95 (in part because EURIBOR 6m became negative in November 2015).

229. Standing back, therefore, and considering the matters discussed in [226] to [228] above:

i) The Transactions were explicitly carried out in the terms adopted both to reduce the risks connected with the Rialto Bond and to cover the winding-up costs of the Bear Stearns IRS (CONSOB Determination (a)).

ii) While many of the terms of the Transactions matched the financial characteristics of the Rialto Bond, important and financially highly significant terms were

arrived at for other reasons (CONSOB Determination (b); the Court of Cassation Decision No 19013/2017, the Court of Rome 8 January 2016, Decision No. 212, the Court of Novara, 24 July 2012, Decision No. 569, and, the Court of Turin, 21 October 2021, Decision No. 4685).

iii) There was a very significant difference between the MTM of the cap and the floor, such that Venice was providing the Banks with a protection of a significantly greater value than the protection it was obtaining from the Banks (the Court of Appeal of Milan in Decision No 2393/2020 and cf *Standard Chartered Bank v Ceylon Petroleum Corp* [2012] EWCA Civ 1049, [9]-[12]).

iv) The fact that the desire to cover the winding-up costs of the Bear Stearns IRS was a highly significant factor in setting the terms of the Transactions itself pointed to the speculative character of the Transactions (Decision of the Court of Orvieto of 12 April 2012 and of the Court of Turin of 21 October 2021 in Decision No 4685/2021). It meant that the Transactions were, to a significant extent, serving the purpose of seeking to address a past adverse event (cf *Standard Chartered Bank v Ceylon Petroleum Corp*, [9]-[12]).

v) The significant non-alignment between the terms of the Transactions and the prevailing forward rate curve was also suggestive of speculation (Supreme Court Decision No 21830/2021).

vi) The fact that Venice took on a significant new risk to which it was not exposed under the Rialto Bond was also suggestive of speculation (Professor Alibrandi's evidence and cf. *Credit Suisse International v Stichting Vestia Gro*e*p* [2014] EWHC 3103 (Comm), [217], *UBS AG v Kommunale Wasserwerke Leipzig Gmb*H [2014] EWHC 3615 (Comm), [159] and *Standard Chartered Bank v Ceylon Petroleum Corp* [2012] EWCA Civ 10494, [9]-[12])).

230. As Venice submitted in its closing, the structuring of the Transactions to cover the costs of winding-up the Bear Stearns IRS with its substantial negative MTM was:

> "akin to borrowing money but instead of repaying it on predictable terms, entering into a bet with a range of possible outcomes. Venice might never have had to repay the Bear Stearns money at all, if rates had suddenly risen to well above the cap and stayed there such that it was in the money throughout the life of the swap. Conversely, Venice might – as has in the event occurred – have had to pay it back many times over, because its impact on the floor level as resulted in Venice paying much more than would otherwise be the case. The only rational basis for proceeding in such a way is the possibility that the bet could have worked out better for Venice than if it had simply paid the Bear Stearns break cost itself …
>
> Borrowing money on terms that one might never have to repay it, might have to repay a much greater sum, or might have to pay anything in between for it depending on where interest rates sit, is speculation".

231. Having regard to the cumulative effect of these factors, and regardless of whatever uncertainties might arise at the fringes of this debate, I am satisfied that an Italian court would clearly find that the Transactions were speculative for the purpose of the legal restriction under Italian law formulated in *Cattolica*. The most that can be said is that

the Transactions served mixed motives (as I accept). However, the Court of Appeal of Milan in Decision No 2393/2020 noted that:

> "An invalidity that - due to its speculative characteristics - must therefore affect the entire contract, and not only the part that concerned the imbalance between the MTM of the cap option and the MTM of the floor option, as also argued in the alternative by the appellant and, in the opinion of this Court, without foundation."

232. In any event the significance of the speculative elements of the Transactions (as outlined at [226]-[228] above) were such that the Transactions can fairly be characterised as predominantly speculative.

J THE INDEBTEDNESS ARGUMENT

Introduction

233. As I have noted at [188] above, it was Mr Cox KC's primary contention that the Supreme Court in *Cattolica* had decided that all IRS transactions involved recourse to indebtedness for the purposes of Article 119(6), and that local authorities could not enter into speculative derivative transactions because they involved indebtedness otherwise than for the purpose of financing expenditure. If he is wrong in that conclusion (which is my determination, and which appears also to have been the view of Cockerill J in *Busto,* [195] and [280]), then Mr Cox KC advances the alternative argument that the Transactions breached Article 119(6) because they involved recourse to indebtedness otherwise than for the purpose of financing expenditure.

234. There is a further complexity that *Cattolica* dealt with the Indebtedness Argument and the Article 42 TUEL Argument together in Section 10, and appears to have adopted a common analysis of what constituted indebtedness for Article 119(6) purposes, and what amounted to "expenditure which commits the budgets for subsequent financial years" for the purposes of Article 42(2)(i) of TUEL.

Can an IRS Transaction Ever Constitute Indebtedness? – the Position Leaving *Cattolica* Aside

235. The Banks argue that, at the relevant time, no IRS transaction could constitute indebtedness. That argument has three principal elements:

   i) First, that IRS transactions do not feature in the list in Article 3(17) of the 2004 Finance Law, which is said to contain an exhaustive definition of what constitutes "indebtedness" for the purposes of Article 119(6).

   ii) Second, that the contrary argument would be inconsistent with the guidance given in the 2007 MEF Circular.

   iii) Third, it is said that the argument is inconsistent with the decision of the Council of State, Italy's highest court in administrative law matters, in Decision No. 3174/2017.

236. As to the first argument, Professors Torchia and Domenichelli held different views on the issue of whether Article 3(17) of the 2004 Finance Law (and any successor

legislation) contained an exhaustive and exclusive identification of what constituted “indebtedness” for Article 119 purposes. In my view, the arguments in favour of the “exclusivity thesis” are formidable:

i) The terms of Article 3(17) of the 2004 Finance Law (“pursuant to Article 119(6) of the Constitution the following constitute indebtedness”; “in addition constitutes indebtedness”; certain operations "do not constitute indebtedness, pursuant to the to the aforementioned Article 119”) are far more redolent of a provision whose purpose is definitional rather than illustrative.

ii) Article 3(18) – identifying what constitutes “investment” for Article 119 purposes – would appear to be exhaustive (and one can see every reason why it should be).

iii) That conclusion is reinforced by the fact that, as originally enacted, Article 3(17) provided that “changes to the aforementioned types of debt are set by decree of the Minister of Economy and Finance, after consulting ISTAT, on the basis of criteria defined at the European level”. Those words were held to be constitutionally illegitimate by the Constitutional Court in Decision No 425 of 29 December 2004 (for reasons which I will turn to shortly). However, the suggestion that Article 3(17) identified “types of debt” to be changed in a particular way and on a particular basis strongly supports the argument that its terms were intended to be exhaustive.

iv) That conclusion is also supported by the Constitutional Court Decision No 426/2004, which addressed a series of constitutional challenges to this part of the 2004 Finance Law. The Court defined the issue before it as follows:

> “The question that arises is whether and to what extent the law of the State can lay down specific rules *concretising* and implementing the constraint laid down in Article 119(6) of the Constitution, in particular by *defining* what is meant, for these purposes, by 'indebtedness' and 'investment expenditure'. These are not notions whose content can be determined a priori, in an absolutely unequivocal manner, on the basis of the constitutional provision alone, of which this Court is able to offer an exhaustive and binding interpretation for all, once and for all. These are notions that are based on principles of economic science, but which cannot fail to give room *for rules of concretisation* marked by some political discretion … The *very definitions* which the State legislature has provided … derive from economic and financial policy charges.”

(emphasis added).

v) The challenge brought to Article 3(17) (together with Article 3(20)) was that “they grant the Minister of Economy and Finance the power, essentially regulatory, to modify by decree the types of operations constituting debt and investment”. That challenge was upheld on the following basis:

> “These provisions (one of which, paragraph 20, partly repeats the provisions of paragraph 17 as regards the types of debt, and extends the same mechanism to the types of investments) grant the Minister a power whose exercise may entail a further restriction of the power of autonomous

entities to resort to debt to finance their expenditure, and essentially translate into a delegation of the provisions contained in the aforementioned paragraphs, which define the notions of debt and investment for the purposes of applying the constraint set out in Article 119(6) of the Constitution to regions and local authorities. 119, sixth paragraph of the Constitution. However, such a provision would presuppose compliance with the principle of substantive legality, under which the exercise of political-administrative power affecting regional autonomy (as well as local autonomy) can be admitted only on the basis of legislative provisions that predetermine in a general way the content of the executive's rulings, delimiting its discretion".

vi) The conclusion that a statutory provision empowering the MEF to add "types of debt" to Article 3(17) was unconstitutional, because this would curtail the autonomy of regions and local authorities without the legislative sanction which Article 3(17) had itself provided weighs strongly against the suggestion that Article 3(17) is not exhaustive, and that it is open to someone other than the legislature (e.g. the courts by way of a process of interpretation of Article 119 of the Constitution or reasoning by analogy) to include new types of transaction within the Article 119 restriction.

vii) Contravention of Article 119(6) exposes public officials to the imposition of very significant penalties. Article 3(15) of Law No. 289/2002 provides:

> "Whenever the territorial entities take on debt to finance expenses other than investment, in violation of Article 119 of the Constitution, the relative acts and contracts are null and void. The regional jurisdiction sections of the Court of Auditors may impose on administrators who have adopted the respective resolutions sentencing to a financial penalty equivalent to a minimum of five and a maximum of twenty times, the reserve indemnity earned upon committing the breach."

That consideration supports an interpretation which limits the concepts of indebtedness and investment for this purpose to transactions specifically enumerated in legislation.

viii) Finally, the subsequent legislative history of Article 3(17) – in which new types of transaction were brought within the Article 119 concept of indebtedness by express enactment – also suggests that the list (as it existed from time-to-time) is exhaustive rather than illustrative. By 2021, the original list had been amended extensively by Article 1(740) of Law 296/2006, Article 62(9) of Legislative Decree No 112/2008 as amended in turn by Article 3 of Law 203/2008 and Article 1(289) of Law 170/2020. It is to be noted that certain of those changes were expressly prospective in effect – for example "financial leasing transactions entered into on or after 1 January 2015" and a provision relating to the provision of guarantees "as of 2015".

237. Professor Domenichelli suggested that the following words in Article 3(17) of Law 350:

> "Operations that do not involve additional resources, but permit to overcome, within the maximum limit established by current State legislation, a temporary

shortage of liquidity and to incur expenses that already have a suitable budget cover, do not constitute indebtedness, pursuant to the aforementioned article 119;"

(which I will refer to as "the negative proviso") carry with them the implication that "all operations" which do not share those characteristics constitute indebtedness, even if they do not fall within the preceding list of debt types.

238. Once again, I found this argument unpersuasive, and found Professor Torchia's contrary view more compelling:

i) Simply looking at Article 3(17) itself, it seems to me more likely that the effect of the negative proviso is to remove transactions within the preceding list of debt types from the scope of Article 119.

ii) On the alternative hypothesis, the word "operations" would be important but extremely vague, potentially bringing a very wide category of transactions into the scope of Article 119 simply because they do not share the characteristics referred to in the negative proviso. By contrast, if the negative proviso is intended to remove transactions of the preceding debt types from the concept of indebtedness for Article 119 purposes, the meaning of "operations" is clear (namely operations within the preceding list).

iii) If the negative proviso is intended to provide an additional, free-standing, test for transactions falling within the concept of "indebtedness" in Article 119(6), it would seem to follow that transactions appearing in the list of debt types would still constitute indebtedness even if they did not involve additional resources and involved expenses that already had a suitable budget cover.

iv) The argument would give Article 3(17) (defining "indebtedness" for the purposes of Article 119(6) which requires "resort to indebtedness only for the purpose of financing investment expenditure") a very different structure to Article 3(18) (defining "investment" for exactly the same purpose), in that the former would include unlisted transactions which did not share the characteristics of the negative proviso, whereas the latter is simply a list of qualifying transaction types.

v) The argument appears to be inconsistent with the judgment of the Constitutional Court in Decision No 425, to the extent that it involves the court adding to the list of transactions constituting indebtedness through the application of the negative proviso.

239. So far as the 2007 MEF Circular is concerned, this stated:

i) "It seems appropriate to remind that the [2004 MEF Circular] of [Decree 389] already included a general consideration that *no derivative is classifiable as a liability* [emphasis in original].

Therefore, derivatives are identified, according to the rules mentioned above, as `debt management instruments and not as indebtedness'."

The reference to the 2004 MEF Circular was to Article 3 thereof which identified permissible types of derivative transactions. A consistent theme of that Article was the need for a sufficient relationship between a derivative and an underlying transaction or liability. In that context, the 2004 MEF Circular stated:

> "In addition, derivative transactions referring to other pre-existing derivative transactions are not allowed, on the basis that no derivative is a liability".

ii) The 2007 MEF Circular went on to state that the 2004 Finance Law had given "a precise and detailed definition of the concept of indebtedness, indicating the types of transactions to be considered as such in reference to the above constitutional law". It then traced subsequent legislative changes to that definition, before summarising the position which had been reached in the following terms:

> "Therefore, in light of the recent legislative changes introduced on the matter, the following have to be considered indebtedness transactions: mortgages and credit openings, bond issuances, securitizations of future income flows, securitizations with initial payment below 85 percent of market price, securitizations guaranteed by other public administrations, securitizations of receivables towards other public administrations, transactions entailing transfer and securitizations of receivables towards suppliers of goods and services.
>
> In conclusion, the definition of swap as mere instrument of debt "management" is further confirmed by the fact that derivative instruments are not mentioned in any of the abovementioned provisions of law; therefore, in light of the above, derivative instruments do not qualify as indebtedness transactions."

240. The 2007 MEF Circular, therefore, is strongly consistent with the view that Article 3(17) as amended exhaustively defined which *transaction types* constituted indebtedness for Article 119 purposes, and that, as a *transaction type* at least, "indebtedness" does not embrace all swaps (a conclusion similar to that reached independently by Cockerill J in *Busto*, [328]). However, neither the 2004 or 2007 MEF Circulars have the force of law, although they express the MEF's official view and are used by judges as an aid to interpretation.

241. So far as the Banks' reliance on Council of State Decision No. 3174/2017, is concerned, that decision considered the application of Article 42(2)(i) of TUEL in the context of IRS transactions. However, as I have mentioned, the Supreme Court in *Cattolica* treated that issue compendiously with the issue of whether the swap transactions in that case constituted indebtedness for Article 119 purposes. In Decision No 3174/2017, a municipality had amended various existing swap agreements for the purpose of restructuring its debt under multi-year instruments. It had later purported to invalidate the amended swaps, inter alia on the basis that they had not been approved by the City Council as required by Article 42(2)(i). That argument succeeded at first instance, but the swap counterparty appealed to the Council of State. The arguments in question appear to have been as follows:

i) On the bank's part that "the purpose of the swaps that were executed was to obtain costs savings based on lower interest paid" on the underlying debt (paragraph 1).

ii) On the municipality's part, that what constituted expenditure depended "on the notion of 'expenditures', regardless of the legal instrument used" and "solely relates to the financial effect of that instrument" (paragraph 9). The municipality also argued that the swaps in question "had a speculative purpose due to the absence of a cap on the interest rates exchanged" (ibid).

242. Neither party, therefore, appeared to be arguing that swaps, as a *type of transaction*, either *a priori* did or did not constitute expenditure within Article 42.2(i), the swap counterparty saying that what mattered was the purpose of the transaction and the municipality saying that what mattered was its effect. While there are certainly passages in the Council of State's judgment which would suggest that any swap which it was lawful for the municipality to enter into will automatically fall outside Article 42.2(i) (paragraph 13), the court's reasoning was that the function of *these* swaps "is … to reduce the financial costs associated with the debt already entered into and thus reduce the risk connected with it" and "the swaps can thus have the purpose of restructuring the debt … in order to obtain costs savings", such that "the reasons that led to entering into *those* contracts are actually antithetical to the rationale for giving the City Council authority over multi-year expenditures under letter i) of Article 42 paragraph 2". Elsewhere the Council of State said that the relevant provisions of TUEL were not relevant "to this case".

243. Further, I accept Mr Cox KC's submission that there had been at least six prior judgments at Court of Auditors level holding that the decision to enter into certain swaps did fall within Article 42(2)(i). Had the Council of State been intending to depart from the view of the law acted on in those decisions, it seems improbable that it would have addressed the issue so briefly and in such general terms.

244. It follows that I agree with Cockerill J's view in *Busto*, [323] that the Council of State did not decide that, as a type of contract, swaps were not capable of falling within Article 42(2)(i), merely that the specific swaps it was considering did not do so.

245. For its part, Venice argued that the Constitutional Court Decision No 52/2010 found that derivative transactions did (or could) constitute indebtedness for the purposes of Article 119(6), which presupposes that Article 3(17) of Law 350 does not contain an exhaustive definition. However, for the reasons I have set out at [189] above, I am not persuaded that the Constitutional Court was addressing, still less determining, this important issue.

246. Finally, it is necessary specifically to consider the status of "upfront" payments under swaps:

i) These were brought within Article 3(17) by an amendment made on 25 June 2008 (by Article 62(9) of Law Decree No. 112 of 25 June 2008):

> "In Article 3, paragraph 17, second sentence, of Law no. 350 of December 24, 2003, after the words: 'assignment of receivables due from other public entities' the following inserted: 'and, based on criteria defined in the

Statistical Office of the European Communities (EUROSTAT), any premiums received at the conclusion of derivative transactions'."

ii) That amendment stated that the contents of the law Decree were "in force as of 1 January 2009" and, on its face, appears only to have prospective effect. It is not, therefore, applicable on its own terms to the Transactions.

247. Standing back, approaching the issue as a matter of principle, and putting the *Cattolica* decision on one side, I see a great deal of force in Professor Torchia's view that Article 3(17) provides an exhaustive definition of what (from time to time) constituted recourse to indebtedness for Article 119(6) purposes. But, of course, *Cattolica* cannot be put aside and I will now turn to it.

What did *Cattolica* Decide on the Indebtedness Argument?

248. There was no dispute that the Supreme Court in *Cattolica* held that at least some derivative transactions constituted indebtedness (for both Article 119 and Article 42 TUEL purposes) and also (implicitly) held that Article 3(17) of Law No 350 did not exhaustively identify which transactions constituted indebtedness for Article 119(6) purposes at any particular point in time. Venice argues that *Cattolica* decided that *all* derivative transactions constituted indebtedness.

249. The *Cattolica* judgment undoubtedly offers paragraphs which, taken in isolation, offer support for both views – so much so, that one might almost imagine that the judgment reflects an attempt to accommodate two divergent views on the subject, with the competing views set out in alternating paragraphs:

i) There is a clear finding that derivative contracts which involve upfront payments constitute recourse to indebtedness (and by implication expenditure for Article 42(2)(i) purposes) ([10.1.3]). That much is not in doubt.

ii) The immediately following paragraph ([10.1.4]) appears to reject the suggestion that swaps which do not involve an upfront necessarily amount to indebtedness:

> "If the money obtained with the upfront must be considered indebtedness, the same cannot be said of the IRSs concluded by public entities which, eventually, may presuppose an indebtedness. A swap transaction must be examined as a whole, because its effects may essentially amount to indebtedness, as was demonstrated by the local entities that were able to use IRSs as loans, and, through them, actually modify and manage the level of the indebtedness (without saying that those IRSs usually arouse of, by law, preceding indebtedness)."

iii) Paragraph 10.2 provides:

> "In regard to the municipal body that is required to authorise the use of IRSs, prevailing legal scholars and case law have, rightfully, held that the City Council has this authority."

Read in isolation, this would suggest that the Supreme Court is expressing its approval of the view expressed by legal scholars and case law that the City

Council must authorise the use of (sc. *all*) IRS transactions. However, if so, that would suggest that this would be the case even in cases when "examined as a whole" (as [10.1.4] requires), the transaction did not "essentially amount to indebtedness". Further, if the reference to "case law" was intended to embrace the Council of State Decision No 3174/2017, it would not be accurate to suggest that this had held that the City Council had to approve *all* IRS transactions (see [241]-[243] above).

iv) By contrast, [10.3] appears to contemplate that the court is considering only two specific issues – whether a swap in the context of debt restructuring and a swap including an upfront clause – constituted indebtedness, rather than any more general enquiry.

v) [10.4] and [10.5] undoubtedly offer support for Venice's interpretation:

a) [10.4] offers a rationale for a requirement of City Council approval (the need to ensure the involvement of minority members) and contemplates that the mere fact that the swap is intended to be debt-reducing is not sufficient to take it outside the City Council's sphere of responsibilities (because although the swaps may have been "concluded … with the purpose of renegotiating loans on more favourable terms" they may "entail expenses … [which] impact financial years after the year the contract was entered").

b) [10.4.1] suggests the City Council needs to approve transactions which "may" impact future financial years.

c) [10.4.2] and [10.5] note that only hedging swaps are permissible, pre-supposing the existence and perhaps the amendment or termination of an underlying debt transaction which will itself have required City Council approval. Those matters provide support for the view that the City Council must approve the swap as well.

vi) By contrast, the immediately following paragraph, [10.6], which appears to have been intended to draw a conclusion from those preceding it ("we must therefore rule") clearly does not hold that all swaps require City Council approval, but only those where certain conditions are met:

> "*If* the IRS concluded by the Municipality affects the total amount of the entity's indebtedness, the financial transaction must, upon penalty of voidness, be authorised by the City Council".

vii) [10.7] is expressed as a conclusion following from the preceding paragraphs ("as a result"). It provides:

> "The appealed judgment cannot be challenged that the swap contract and, particularly, (but not only) the contract that included an upfront clause constituted, because of its aleatory nature, a form of current or potential indebtedness for the public entity".

The reference to the conclusion of the Court of Appeal of Bologna, and the language which clearly repeats the summary of the conclusion of the Court of

Appeal which the Supreme Court had previously set out at [2.1(a)], does suggest that the Supreme Court was endorsing the conclusion reached by the Bologna Court of Appeal. It is less clear whether that is a conclusion which is concerned with the specific swaps in issue, or a more general conclusion (although, notably, both paragraphs refer to "the swap contract").

250. That leaves what both parties recognise is an important paragraph: [10.8]. Before turning to it, it is important to remember that the Council of State, Italy's highest administrative court, had held that at least some swap transactions did *not* fall within Article 42(2)(i) ([241]-[244]). In referring the appeal to the Joint Divisions of the Supreme Court, in paragraph 12 of its Interlocutory Order, the First Civil Division had expressly referred to that decision of the Council State. If the Supreme Court had wanted to arrive at the opposite conclusion, this was a conclusion which ought to have arrived with a bang, rather than a whimper. Further, [10.8] is the final substantive paragraph of the judgment, and one which clearly seeks to formulate a set of legal propositions so far as the first and second grounds of appeal are concerned ("the rule of law that"). It followed paragraphs which, as has been seen, offered conflicting indications on the application of Article 42(2)(i) to derivative transactions. If there were voices within the Supreme Court who wanted the Court to adopt a rule that all swap agreements required City Council approval under Article 42.2(i), this was the paragraph, above all others, in which that conclusion had to be manifest.

251. But it was not. Instead [10.8] provides:

> "In conclusion, those additional grounds must also be dismissed, according to the rule of law that:
>
> Authorisation for Italian Municipalities to conclude a swap contract, especially if they are of the type with an upfront loan, but also in all cases where its negotiation entails extinction of the previous underlying loan agreements or even if they remain outstanding, but with significant modifications, must be given, upon penalty of voidness, by the City Council pursuant to Article 42, paragraph 2, letter i) of the T.U.E.L. under Italian Legislative Decree No. 267 of 2000 where it provides that "The city council's authority extends solely to the following fundamental actions: (...) ~ expenditures that affect budgets for subsequent financial years (...)"], as this is not comparable to mere act of management of the local entity's indebtedness aimed at reducing the financial costs inherent to it, which can be adopted by the city board pursuant to its reserved managerial authority under Article 48, paragraph 2 of the T.U.E.L."

252. In short, *Cattolica* holds that Article 42(2)(i) (and by implication Article 119(6)) applies to the following swaps:

i) Swaps "if they are of the type with an upfront loan".

This picks up the statements that a swap with an upfront provision constitutes indebtedness in [10.1.2] and [10.1.3].

ii) If the negotiation of the swap "entails extinction of the previous underlying loan agreements".

This picks up the reference to the termination of indebtedness in [10.5].

iii) If the negotiation of the swap entails significant modifications of the underlying loan agreements, even if they remain outstanding.

This picks up the reference to amending the underlying contract including "by extending the length of the debt exposure" in [10.5].

It follows that I have arrived at the same conclusion as that reached by Cockerill J in *Busto*, [325]. Cockerill J regarded that outcome as being one which "apparently sounds good sense" ([327]). Venice describes the Banks' fallback case in reliance upon it as having been "adopted opportunistically rather than on a principled basis". Even if that latter characterisation is correct, it is clear that the status of IRS transactions entered into by local authorities raises a number of conflicting interests, policy considerations and legal principles. If the decision in *Cattolica* as Cockerill J and I have interpreted it is an act of judicial pragmatism rather than a principled determination, that does not affect its status as a statement of Italian law.

253. So far as subsequent cases and academic commentary are concerned:

i) The Court of Appeal of Venice in Decision No 696/2022 referred to *Cattolica* as having decided that City Council approval was required for swaps which involved an upfront payment or entailed the extinguishing or significant modification of the underlying loan, as did the Court of Appeal of Rome in Decision No 6894/2021 (in which they engaged in analysis which would have been wholly unnecessary if Venice's interpretation of this aspect of *Cattolica* was correct) and the Court of Auditors of the Lazio Region in Decision No 42/2022 also quoted only [10.8] of the judgment when summarising the Supreme Court's decision on this issue.

ii) The Berti Article described the Supreme Court as having held that City Council approval was required in "at least two cases", being the two instances referred to in [10.8]. The Banks have informed the court that Andrea Berti was Cattolica's in-house counsel, which makes the absence of any statement that City Council approval is always required for swaps noteworthy.

iii) By contrast, the Court of Appeal of L'Aquila in Decision No 567/2021 referred to Article 42(2)(i) being engaged "on the execution of a swap on the part of a local authority".

254. These materials do not persuade me that the interpretation which Cockerill J and I have adopted of *Cattolica* is wrong, and, on balance, they support it.

Does *Cattolica* Correctly State Italian Law in this Respect?

255. The Banks argued that *Cattolica* was wrong to decide that *any* IRS transactions could constitute recourse to indebtedness, until Decree 2008 came into effect, and then only so far as derivatives involving upfront payments are concerned.

256. My concerns at the manner in which the Supreme Court, through what it described as a process of interpretation:

i) effectively did what the Constitutional Court had held could only be done by legislation, and added new categories of indebtedness to the scope of Article 119(6); and

ii) held that derivative transactions which involved upfront payments constituted recourse to indebtedness even before Decree 2008 had made an explicit legislative change to this effect, which was specified to take effect in 2009;

will already be apparent.

257. However, for similar reasons to those given when addressing the Speculation Argument above, I do not feel able to say that this does not represent Italian law. On this occasion, the Supreme Court had sat in Joint Divisions squarely to consider this argument, which had already found favour with the Court of Appeal of Bologna. The decision has since been followed by the Court of Appeal of Rome in Decision No 6693/2021 of 20 October 2021 which observed of *Cattolica*:

> "BNL … argued that at the time the contract at issue was entered into (2005) the swaps with upfront were fully legitimate and did not fall within the notion of indebtedness, and this latter conclusion had also been expressly indicated by the Ministry of the Economy in the cited circular no 63013 of 22.06.2007. However, it should be noted that the Unified Sections of the Supreme Court, which enunciated the aforesaid maxim in relation to cases in which the contracts in question were stipulated in 2003 and 2004 affirmed the interpretative nature of the new rules (Article 62, paragraph 9 of Law Decree No 111/2008 which amended Article 3, paragraph 17 of Law No 350/2003) which for the first time defined the '*upfront'* as '*debt*' so that it did not set limits for the future on the use of derivatives by public administration but it did *"interpret"* the pre-existing negotiating and regulatory reality".

Did the Transactions Fall Within the Categories of Indebtedness Identified in *Cattolica*?

258. Venice's pleaded case as to why the Transactions constitute indebtedness is set out at Defence ¶11A:

i) The "significant negative mark-to-market value of the Transactions" and "the fact that there was a 72% likelihood that [the Transactions] would result in a net loss to Venice", meaning "it was very likely (and has proved to be the case) that Venice would have to pay millions of euros to the Banks over the following years" which "was a commitment of a material proportion of Venice's future resources" ("the First Argument").

ii) "The Transactions formed part of a major restructuring of Venice's borrowings and associated derivatives whereby the maturity of the debt and termination date of the derivatives were both deferred for a period of 15 years until December 2037 and their respective terms varied" ("the Second Argument").

259. Further, paragraph 41G(a) of Venice's Reply to Defence to Counterclaim pleads that the sums applied to close out the Bear Stearns IRS were "upfronts … for the purposes of the Italian laws on which Venice relies". That was supplemented in Venice's opening where what is now Venice's principal case that the Transactions involved an "upfront"

in the form of the payment made to unwind the Bear Stearns IRS is clearly set out ("the Third Argument"). I accept that the Third Argument is open to Venice.

260. The Third Argument relies on the fact that the €8,065,000 paid by the Banks to Bear Stearns under the Novations to wind-up the Bear Stearns IRS was then "priced in" to the terms of the Transactions. Venice argues that this is as much an "upfront" as if the payment had been made by the Banks to Venice which had itself paid Bear Stearns to unwind the Bear Stearns IRS. In response, the Banks argue:

> "The question is therefore whether the Banks' payments to Bear Stearns under the Novations amounted to an 'upfront payment' to Venice. The Banks submit that, plainly, they did not. These payments were not any form of compensation provided by the Banks to Venice. They were instead the price which the Banks, as transferees, needed to pay to buy out the existing rights of the transferor, Bear Stearns, under the Novations. That was a necessary part of enabling the Bear Stearns IRS to be unwound …"

261. I am satisfied that the amount paid by the Banks to Bear Stearns and then "embedded" into the terms of the Transactions constituted an "upfront" for the purposes of the *Cattolica* principles:

i) The rationale for treating a swap with an upfront payment by the bank to the local authority as expenditure or indebtedness is because it involves taking a benefit at one point in time (and in one financial year) in return for structuring the transaction in a manner which, in Day 1 PV terms at the date of transacting, is adverse to the local authority, with the attendant enhanced risk of payments by the local authority in subsequent financial years. It may be that there will never in fact be a negative cash outflow by the local authority (because the market moves in a manner which ultimately reverses that adverse Day 1 PV from the local authority's perspective). However, *Cattolica* decides that, as a matter of Italian law, that risk is sufficient to engage Articles 119(6) and 42(2)(ii).

ii) That rationale is equally applicable in the present scenario. There was "jam today" (in that the funds were made available to meet the price of exiting a transaction which Venice wished to exit) in return for accepting a greater risk of bare bread tomorrow. The fact that the "upfront" here was not paid to neutralise an imbalance in the MTM of the respective obligations, but the respective obligations are structured in an unbalanced way to cover the cost of the "upfront" does not negate the issues of inter-budgetary equity which Article 42(2)(i) recognises nor the limits of Article 119(6) as established in *Cattolica*.

iii) I accept Mr Cox KC's argument that the fact that the payment in question moves from the Banks to Bear Stearns rather than through Venice does not change the analysis. Professor Gentili accepted in cross-examination that if A (sc Venice) had asked C (sc the Banks) to make the payment to B (sc Bear Stearns), it would still be treated as an upfront payment by C to A (Day 6/107). That is essentially what happened.

iv) While in no way determinative, it is noteworthy that the Banks referred to the payment being made to Bear Stearns to unwind the Bear Stearns IRS as an upfront. A particularly telling internal communication, in the context of the case

as a whole, was a note prepared by Intesa in 2009 when explaining the high negative MTM of the Transactions from Venice's perspective by "the need to absorb the Upfront paid to the municipality for the early termination of the derivative with Bear Stearns".

262. So far as the Second Argument is concerned, the Banks argue that:

> "The second and third situations described by ***Cattolica*** involve, respectively, the extinguishing and modification of pre-existing loans. But the Transactions did not extinguish or modify (and were not themselves) 'loans'; they were debt management instruments, entered into by Venice to hedge its interest exposure on debt (i.e., the restructured Rialto Bond) …
>
> It is correct that the Transactions formed part of a major restructuring of Venice's borrowings under the Rialto Bond and that the restructuring of the Rialto Bond was a significant modification of Venice's debt affecting its budget for future financial years. However, it does not follow that the Transactions *also* modified Venice's debt. The Transactions had no effect on the principal amount owing under the Rialto Bond, which remained the same following the restructuring (albeit with an extended maturity date). Venice's argument would mean that any swap which hedged an underlying loan, where that loan was simultaneously restructured in a way that significantly modified a borrower's debt, would itself require City Council approval. That cannot be spelled out of TUEL Article 42 or from the treatment of that provision in ***Cattolica***."

263. This argument assumes that a swap which "entails extinction of the previous underlying loan agreement" or "significant modifications" to the underlying loan agreement will only apply where *the swap itself* extinguishes an existing loan or modifies that loan, rather than being entered into as part of a restructuring which involves such changes.

264. In the course of oral closing argument, I (rashly) expressed the view that it was difficult to identify a case in which *the swap itself* will extinguish or modify an underlying loan. Mr Dhillon KC's team disagreed with that view, and provided a note addressing this topic. The note did not explain how a swap could extinguish an existing loan but it did offer a scenario in which a swap would have the economic (although not the legal) effect of extending the term of a loan or altering its amortisation rate, while leaving its terms in place:

> "The example is a cashflow swap in which the bank and the local authority swap cashflows by reference to different underlying obligations. This could include the cashflows which would be due on an actual underlying loan and the cashflows which would be due on a different hypothetical loan."

The examples given involved, in effect, cases in which the bank would make payments equivalent to the amounts due under the existing loan on the dates they were due, in return for the local authority making the payments to the bank which would have fallen due had the loan been for a longer period or had a different amortisation profile.

265. I accept that there is scope for argument as to whether, when referring to swaps whose "*negotiation entails* extinction of the previous underlying loan agreements or even if they remain outstanding, but with significant modifications", the Supreme Court was

intending only to refer to swaps entered into to change the economic effect of an outstanding loan without changing its terms. That interpretation would embrace "cash flow" swaps (under which different principal amounts were swapped, sometimes over different periods) which were clearly a widely used form of derivative transactions in which Italian local authorities were involved, albeit the *Cattolica* decision was not concerned with a swap of that type, but only with IRS transactions.

266. Elsewhere in the judgment, the Supreme Court had noted the legal nexus required between a permissible IRS and an underlying debt transaction because local authorities could only enter swaps for hedging purposes ([10.4.2]). It is certainly arguable that it is for that reason that the Supreme Court concluded that it was appropriate to link the circumstances in which City Council approval for an IRS was required with associated changes to the underlying debt transaction in [10.5], [10.6] and [10.8], which provides support for the argument that the word "entails" in [10.5] and [10.8] is not limited to those cases where it is the terms of the IRS transaction itself which economically effect the termination or modification of the underlying debt transaction, but embraces those cases in which the IRS is a component of a restructuring package undertaken to terminate or modify the underlying debt exposure. It does not appear that Cockerill J in *Busto* interpreted this part of *Cattolica* as applying to swaps which adjusted the economic effects of loan transactions. As I understand the facts in *Busto*, there was no change to the terms of the underlying indebtedness effected as part of the transaction of which the swaps formed part, but the economic effect of the Cash Flow Swap was to "smooth" the payment profile on Busto's part within the existing debt term. On the Banks' analysis, it would appear that that would have constituted a significant modification of the economic effects of the loan, but that was not Cockerill J's conclusion (see *Busto*, [341]-[342]).

267. However, it is not necessary for me to reach a final view on the Second Argument (nor indeed on the First Argument), and I will refrain from doing so. The effect of my conclusion on the Third Argument is sufficient to establish that the Transactions involved recourse to indebtedness for the purposes of Article 119(6) of the Constitution.

268. As to the second element of Article 119(6) ("for the purpose of financing investment expenditure"):

i) It follows from my conclusion that the Transactions, as a whole, were speculative that they were not undertaken for the purpose of financing investment expenditure.

ii) In any event, focussing on the upfront payment which (per Cattolica) was the loan element which rendered the Transactions a recourse to indebtedness, that was not entered into for the purpose of financing investment expenditure, but in order to meet the winding-up costs of the Bear Stearns IRS. I do not think it is sufficient, as the Banks contend, to argue that the Rialto Bond was issued to finance expenditure, and that the upfront was paid as part of a transaction undertaken to restructure that debt (the "ancestor" indebtedness argument).

iii) That will be the case in many of the IRS transactions entered into by Italian local authorities, which often involved the restructuring of underlying loans and their associated IRS transactions, with the upfront for the new IRS transaction covering

the negative MTM on the original swap. It will be recalled that this was the background to the second swap transaction in *Cattolica* itself (see [213]).

iv) The upfront paid to the benefit of Venice in this case did not in any way reduce or replace the outstanding amount under the Rialto Bond, but created "new debt".

269. The conclusions at [267] and [268] necessarily entail that the Transactions contravened Article 119(6) of the Constitution.

K WHAT ARE THE CONSEQUENCES AS A MATTER OF ENGLISH LAW OF THE FINDING THAT THE TRANSACTIONS WERE SPECULATIVE AND/OR CONTRAVENED ARTICLE 119(6) OF THE CONSTITUTION?

270. I have set out above at [197]-[201] my reasons for concluding that, on the basis of the *Cattolica* decision the restriction on local authorities entering into speculative derivatives which *Cattolica* derived from Articles 119(4) and (6) of the Constitution had the effect that local authorities had no substantive power or legal ability to enter into such transactions rather than a measure prohibiting a local authority from entering into a contract which it had power to enter into. It seems to me unrealistic to contend that *Cattolica* regarded Article 119(6) in its direct application as having any different effect, and in any event the language of Article 119(6) (local authorities "*may* have recourse to indebtedness *only* for the purpose of financing investment expenditures") is itself suggestive of a limitation on the power of local authorities.

271. In any event, applying the criteria I identified at [112] above, I am satisfied that the restrictions on local authorities in relation to the entry into transactions arising under or derived from Article 119 are, as a matter of English law classification, provisions which mean that a local authority lacks the legal ability or substantive power to enter into a valid contract with a counterparty of the infringing kind, rather than a prohibition against exercising a legal ability or substantive power which it did have:

i) Article 119 is specifically directed to local authorities, rather than a provision of general application, and is directed to the entry by local authorities into transactions of a specific type.

ii) The restriction imposed does not relate to an activity which is inherently wrongful, but on the contrary an activity which is lawful for other legal and for natural persons.

iii) Article 119(6) specifically confers the power to have recourse to indebtedness on local authorities, but does so in terms which restricts that power to indebtedness for a particular purpose (like s.50 of the Norwegian Local Government Act 1992 considered in *Haugesund*). Like s.50, the effect of Article 119 is "both to grant power … to conclude certain types of loan contract and also to restrict their power to conclude certain types of loan".

272. As I noted at [198] above, it is Professor Torchia's evidence that Articles 119(4) and (6), and any restriction *Cattolica* derived from them, did not restrict the capacity of local authorities to contract as a matter of Italian law, relying on the following matters:

i) Local authorities have general contractual capacity under Italian law.

ii) Article 3(15) of Law No. 289/2002 provides that where a local authority takes on debt for a purpose other than investment in violation of Article 119, the relevant acts and contracts are "null and void" and an administrative penalty can be imposed on the relevant administrators. It is said that this is more consistent with Article 119 imposing a prohibition than a restriction on a local authority's capacity.

iii) It is pointed out that the local authority (but not its counterparty) is able to enforce contracts which infringe the 2008 Decree and the 2013 Finance Law.

273. Venice did not take issue with any of those statements of the position under Italian law (although it submitted that the reference to Article 3(15) did not take the Banks very far, because if Article 119 limited the substantive powers of the local authorities, the expected consequence would be that the purported transaction would be "null and void"). However, it points to the fact that, on the authority of *Haugesund*, [60], once the English court has classified the restriction on the legal person arising under the foreign legislation as amounting to a restriction on capacity, the consequences for that decision on an English law contract are a matter for English law. In this regard, the fact that the foreign legal system does not recognise a doctrine of *nec ultra vires* as English law does, but rather confers general contractual capacity on legal persons subject to such specific restrictions as the law imposes, or that it permits enforcement of the terms of contracts of the proscribed kind in certain circumstances, does not change the position. That was also the position in *Haugesund* ([55]).

274. Applying English law, and on the basis of *Haugesund*, the inevitable consequence of my conclusion that, on the basis of the Speculation and/or Indebtedness Arguments, Venice lacked the substantive power or legal ability to enter into the Transactions, is that they are void. In this regard, this case might be said to present a more compelling case for such a conclusion that *Haugesund*, in which the swap transactions would, as a matter of Norwegian law, have been enforceable against the local authority under provisions protecting those dealing with such entities in good faith ([55]). The outcome which particularly troubled Etherton LJ in that case – that "the swaps contracts would be bound to be treated as void in the English courts, under a contract governed by English law, even though English domestic law would treat them as valid and enforceable, and even though Norwegian private law would also treat them as valid and enforceable" ([136]-[137] and [144]) – does not arise. So far as the Banks are concerned, at least, the conflict of laws aspects of this issue present what US lawyers would refer to as a "false conflict".

275. I have reached this conclusion with some diffidence. That is not because of any reluctance to find that a financial transaction which a local authority was fully content to enter into in what it saw as its own best interests is of no effect because it exceeded the substantive powers of the local authority. The particular legal and political risks of entering into derivative contracts with local authorities would have been well known to all when the Transactions were negotiated and entered into, not least because of the wave of English local authority swaps litigation which had unfolded some 20 years before. In any event, those risks in a specifically Italian context were highlighted shortly before the Transactions were finalised (see [41] and [90]).

276. However, it is a striking feature of this case that it is a decision of the Supreme Court in 2020, some 13 years after the Transactions were entered into, which has completely

altered the legal landscape and compelled me to conclude that, in English law terms, Venice lacked the capacity to enter into the Transactions. At least on the material before me (and I accept that it is possible that the road to *Cattolica* may have been a good deal longer and more winding than the sudden sharp turn it appeared to be in this case), the Supreme Court decision in *Cattolica* involved a very significant discontinuity with Italian law as it was understood and applied at the time the Transactions were finalised. Berti described the decision as involving a "fundamental moment of rethinking". It is noteworthy that:

i) on Venice's own case, the principle of law it relied upon in support of the Speculation and Indebtedness Arguments emerged "first and foremost from *Cattolica*", and is "an important principle which emerges from recent Italian jurisprudence"; and

ii) in relation to the issue of indebtedness, and in particular the status of "upfronts", the Supreme Court by a process of what it described as interpretation concluded that legislation introduced by Decree 2008 and which took effect in January 2009 was simply stating the law as it had existed from 2001.

277. There may be room for a legitimate debate as to whether, when the issue arises before an English court, the security of obligations governed by English law should be capable of being subject to a continuing jurisprudential jeopardy of this kind arising from the courts of the domicile of one of the contracting parties (see [116]-[119] above).

L THE ARTICLE 42(2)(I) TUEL ISSUE

Introduction

278. This issue turns, in the first instance, on the interpretation of TUEL. Article 42 of TUEL provides:

> "Attributions of City and Province Councils
>
> 1. City and Province Councils are the political-administrative guidance and control bodies.
>
> 2. City and Province Councils shall be responsible only in respect of the following fundamental acts:
>
>   i) expenditure which commit the budgets for subsequent financial years, with the exception of expenditure relating to the rental of buildings and the supply of goods and services on a continuing basis."

279. The issue in this case is whether the decision to enters into the Transactions falls within Article 42(2)(i), so as to require approval by the City Council (and, if so, whether such approval was given).

280. So far as matters which do not require the approval of the City Council under Article 42 of TUEL are concerned:

i) Article 48 deals with the "Competences of the City Board". Article 48(2) provides:

"2. The city board performs all acts pursuant to Article 107, paragraphs 1 and 2, in the functions of government bodies, which are not reserved by law to the city council and that do not fall within the powers, provided for by law or by the statute, of the mayor or of the president of the province or of the decentralization bodies; it collaborates with the mayor and the president of the province in the implementation of the general guidelines of the city council; it reports annually to the city council on its activities' and it carries out proposal and impulse activities towards the same (the city council)."

ii) Art. 107, headed "Functions and responsibilities of the city servants", provides:

"1. Civil servants are responsible for managing offices and departments according to the criteria and rules laid down by the statutes and regulations. They comply to the principle by which the powers of guidance and political administrative control are the responsibility of government bodies, while the administrative, financial and technical activity is attributed to municipal servants through autonomous powers of expenditure, organization of human resources, control and instrumental power.

2. Civil servants are responsible for all tasks, including the adoption of administrative acts and measures that commit the administration externally, which are not expressly included by law or by the municipal statute among the functions of political-administrative direction and control of the governing bodies of the entity or not included among the functions of the secretary or general manager, as per articles 97 and 108 respectively. Art. 147(4)."

281. Finally, Article 192 provides:

"Determinations to stipulate and related procedures

1. The stipulation of the contracts must be preceded by a specific determination by [the person/civil servant] in charge of the expenditure procedure indicating:

a) the purpose that the contract intends to pursue;

b) the object of the contract, its form and the clauses considered essential;

c) the methods for choosing the contractor admitted by the provisions in force regarding public administration contracts and the underlying reasons.

2. In any case, the procedures established by the implemented European Union legislation or in any case in force in the Italian legal system apply."

282. The words in square brackets in Article 192(1) reflect the competing translations used by Professors Domenichelli and Torchia respectively, a dispute which unfortunately

was only crystallised in a footnote in Venice's closing argument which offered a third translation more clearly capable of embracing a body as well as a single natural person.

Does Article 42(2)(i) Apply to IRS Transactions At All?

283. The argument on this issue proceeded on the basis that, to fall within Article 42(2)(i) of TUEL, the Transactions had to constitute a form of actual or potential indebtedness. At first sight, the use of the concept of indebtedness as the touchstone of this argument is curious, because, unlike Article 119(6) of the Italian Constitution, Article 42(2)(i) uses the language of "expenditure", not that of indebtedness. Further, Article 202 of TUEL expressly addresses "the recourse to indebtedness" by local authorities in a different context, which (from an English lawyer's perspective at least) might suggest that the fact that the term "indebtedness" was not used in Article 42(2) is significant.

284. However, for their own forensic reasons, both sides proceeded on the basis that the issue to be decided for Article 42(2)(i) purposes is whether the Transactions constituted "indebtedness", and hence raised the same question as that arising under the Indebtedness Argument:

i) From Venice's perspective, *Cattolica* approaches the issue of whether Article 42(2)(i) is engaged by reference to the concept of indebtedness, and repeatedly stresses the close link between that issue, and the issue of whether there has been a breach of Article 119: see for example the introduction to [4] ("the first three grounds for the main appeal … were connected"); [4.1] ("two issues that were closely connected"); [3] of the Reasons section ("two closely related questions"); and section 10 *passim*.

ii) From the Banks' perspective, accepting this equivalence allowed it to run its argument that Article 3(17) of the 2004 Finance Law contained an exhaustive definition of indebtedness which did not include IRS transactions.

However, I do not think that Venice actually conceded that, if its argument as to the non-exhaustiveness of Article 3(17) of the 2004 Finance Law was rejected, it followed that Article 3(17) of the 2004 Finance Law determined not only what constituted indebtedness for the purposes of Article 119, but also what did and did not constitute expenditure for Article 42(2)(i) purposes.

285. For my part, I am not satisfied that the definition of "indebtedness" for Article 119(6) purposes necessarily answers the question of whether or not a transaction constitutes expenditure for the purpose of Article 42(2)(i) of TUEL:

i) Article 3(17) does not purport to specify indebtedness for the purposes of Article 42(2)(i) of TUEL, but only for the purpose of the limitation in Article 119(6) of the Italian Constitution. Thus paragraph 17 provides:

> "For entities, referred to in paragraph 16 above, *pursuant to article 119(6) of the Constitution* the following constitutes indebtedness".

ii) The purposes of the two provisions are not the same. Article 119 of the Constitution is concerned with limiting the purposes for which a particular liability can be incurred, and creates an absolute prohibition against incurring

liabilities of the relevant kind save for a particular purpose. Article 42(2)(i) is concerned with the duration of the commitment rather than the purpose for which it is incurred, and addresses the issue of who is entitled to take the decision to incur the commitment rather than prohibiting such transactions altogether.

iii) The decision of the Council of State, Italy's highest court in administrative law matters, in Decision No 3174/2017, when considering whether swap transactions which had been entered into without complying with Article 42(2)(i) of TUEL were enforceable, does not refer to Article 119 of the Italian Constitution nor Article 3(17) of Law 350/2003.

286. As I have mentioned, the Banks relied on Decision No 3174/2017 to support the proposition that no derivative contracts fall within Article 42(2)(i) of TUEL, but I do not accept that argument for the reasons set out at [241]-[244] above. I have concluded that the Supreme Court in *Cattolica* held that only some swap transactions fall within Article 42(2)(i) of TUEL ([248]-[254]) and that I should accept *Cattolica* as establishing the content of Italian law on this issue ([255]-[257]). I have much less reluctance in doing so on the Article 42(2)(i) issue, than in the context of the Indebtedness Argument, for the reasons identified in [285] above. Further, *Cattolica* has been followed in this regard by subsequent decisions: the Court of Appeal of Venice in Decision No 696/2022, the Court of Appeal of L'Aquila in Decision No 576/2021; the Court of Appeal of Rome in Decision No 6894/2021 and the Court of Auditors of the Lazio Region in Decision No 42/2022.

287. While it probably does not matter, I was not persuaded that Article 42(2)(i) has a wider import as a matter of Italian law so far as derivative transactions are concerned than the specific instances identified in *Cattolica*. Professor Domenichelli contended that this followed because Article 42(2)(i) reflected a general principle of "budgetary equilibrium", and should be interpreted so as to give effect to that principle. He elaborated on that principle as follows:

> "Revenues and costs associated with indebtedness must be certain, in the sense that they must be rationally predictable and cannot expose the public budget to an erratic performance that does not make it possible to guarantee continuity in planning and the achievement of its aims."

In closing submissions, Mr Cox KC submitted that a purpose of Article 42(2)(i) was to bring the regime for approving individual "off-balance sheet" expenses into line with those subject to approval within the multi-year budget (something which was common ground between Professors Torchia and Domenichelli).

288. However, these are very generalised principles, which a legislative regime applicable to local authorities could chose to pursue with varying degrees of zeal or specificity. Reverting to Article 42(2)(i), the entry of a long-term contract relating to the supply of goods and services would be capable of having a material impact on the budget for future years, with the risk of market movements making such payments unprofitable from the local authority's perspective or involving a commitment to acquire goods and services which are no longer required. Yet Article 42(2)(i) does not require such a decision to be taken by the City Council, any principle of "budgetary equilibrium" notwithstanding. In the final analysis, the issue is what the relevant legislation, as interpreted by the Italian courts, requires as a matter of Italian law, not what the purest

application of a principle of "budgetary equilibrium" might require. That is also true of the reliance Venice places on "the constitutional rationale" of Article 42(2)(i).

Did the Transactions Require City Council Approval Under Article 42(2)(i) of TUEL?

289. I have set out my reasons at [260] to [261] above for concluding, on the basis of the *Cattolica* decision, that the Transactions fell within one of the categories of derivative which the Supreme Court held constituted indebtedness or expenditure for the purposes of both Article 119(6) of the Constitution and Article 42(2)(i) of TUEL (the Supreme Court having addressed these issues compendiously).

Was the Requisite Approval Given?

Introduction

290. It was agreed by the parties that a resolution under Article 42(2) had to be in writing. There is no express requirement in Article 42(2) to this effect, but both Professors Domenichelli and Torchia were content to deduce such a requirement from Article 124 of TUEL, which requires all Municipal Authority resolutions to be published on the council noticeboard for a set period. The issue of whether a resolution which was not set out in written form could ever be valid, or whether it was simply not valid until publication, was not explored in the evidence.

291. Venice goes further and argues that:

i) the (ex hypothesi written) resolution by the City Council must comply with Article 192 of TUEL (which I understand to mean both that the decision must have addressed the matters in Article 192 and that those matters must be addressed in the written document, imposing a requirement both as to the nature of the City Council's decision-making and the form in which it is expressed); and

ii) the effect of *Cattolica* is that (whether or not Venice is right in contending that the Article 192 requirements apply to a decision of the City Council) the matters which Article 192 require to be included in the resolution include "the MtM, the price of the proposed transaction, the consequent adjustments to the budget, the hidden costs, the presence of any upfront clause and the probabilistic scenarios" (which appears to be the qualitative distribution of the probabilities of which the MTM is the weighted average) – information referred to as "the Required Information".

Does Article 192 Apply to the City Council?

292. At first sight, the suggestion that Article 192 sets out requirements for the decision of the City Council in respect of a "fundamental matter" within Article 42(2) – to the extent that the decision will culminate in the entry into a contract – seems improbable:

i) At least in the translations before me, Article 192(1) is addressed to "the person/civil servant/[responsible party] in charge of the expenditure procedure", not the City Council. When I asked Mr Cox KC in the course of oral closings how I was to resolve the dispute as to the interpretation of the provision at that stage, he expressed confidence that the issue could be agreed, but went onto confirm

that Venice accepted that the language of Article 192 indicated that its contents were addressed to those with technical rather than political responsibilities.

ii) Articles 42 and 192 appear in very different sections of TUEL: Article 42 in Part I ("Institutional Ordinance") Title III ("Organs") Chapter I ("The governing bodies of the municipality and the province") and Article 192 in Part II ("Financial And Accounting Order") Title III ("Management of the Budget") Chapter 4 ("Principles of management and management control").

iii) The technical content of Article 192 – identifying the key clauses and the tender process – are matters of obvious relevance to the executive branch of the municipality, but outside the ordinary experience and competence of the elected members of the City Council.

iv) That analysis, which was put forward by Professor Torchia, is supported by Article 107 of TUEL which provides:

> "Functions and responsibilities of the city servants
>
> 1. Civil servants are responsible for managing offices and departments according to the criteria and rules laid down by the statutes and regulations. They comply to the principle by which the powers of guidance and political-administrative control are the responsibility of government bodies, while the administrative, financial and technical activity is attributed to municipal servants through autonomous powers of expenditure, organization of human resources, control and instrumental power.
>
> 2. Civil servants are responsible for all tasks, including the adoption of administrative acts and measures that commit the administration externally, which are not expressly included by law or by the municipal statute among the functions of political-administrative direction and control of the governing bodies of the entity or not included among the functions of the secretary or general manager, as per articles 97 and 108 respectively."

The activities contemplated by Article 192 naturally fall within the matters for which civil servants are responsible within the dichotomy which the second sentence of Article 107(1) creates.

v) It is also supported by the following passage from the decision of the Administrative Regional Tribunal of Calabria Decision No 153 of 13 February 2004:

> "In local authorities, according to art. 32 and 56 of the law n. 142 of 1990, the resolution to negotiate was the responsibility of the Council; today, however, 'the determination to contract', while maintaining the same contents (it must, in fact, always specify the purpose that the contract intends to pursue, the object of the contract, its form and clauses deemed essential, as well as the methods for choosing the contractor admitted by the provisions in force on public administration contracts and the reasons

of this choice), is a management act, which is the responsibility of the person in charge of the expenditure procedure (art. 192 TUEL), which follows the resolution of council, expression of the power of direction and political-administrative control (art. 107, paragraph 1, TUEL). On the other hand, it is the managers who must implement the objectives and programs defined with the guidelines adopted by the council and it is they, in particular, who assume the responsibilities of the procurement procedures (Article 107, paragraph 2, letter b)."

vi) Finally, it receives significant support from the Council of State Decision No 4192 of 20 August 2013.

a) That decision emphasised the constitutional significance of the different roles of the City Council, the City Board and the directors in what was referred to as a "distribution of responsibilities between political and bureaucratic bodies as outlined by [TUEL]". That division of responsibilities was adopted "to convert the Municipal City Council from a body with general and residual jurisdiction … into a body with specifically identified and exclusive powers", in order "to make the Municipal Council's institutional life lighter, as this was notably weighed down by all the myriad of tasks [that] burden the Council".

b) The argument that the terms of the Article 192 (and the technical requirement it imposes) applies to the City Council cuts across that "distribution of responsibilities." The Council of State observed that "the Municipal City Board is a governing body of the local authority and therefore performs a function of political implementation of the fundamental choices made by the Municipal City Council, while the directors are responsible for technical, financial and accounting management and for taking all the administrative measures or acts of private law necessary to achieve the objectives established by the governing bodies".

293. Leaving the *Cattolica* decision to one side for the moment, Professor Domenichelli's contrary view is as follows:

> "As far as the procedural sequence is concerned, there is first a resolution issued by the Municipal Council, in the cases described in Article 42 of TUEL (or by the Council Board in all the cases described just above), which is followed by the decision to enter into a contract pursuant to Article 192 of TUEL, which is the duty of the individual responsible for the cost procedure (*which, in cases where the Municipal Council or Council Board has the power, is limited to referring to, if not actually copying, the resolution passed by the above-mentioned collegial bodies*), and finally the entering into of the contract by the sector manager (who may also be the same person who is responsible for the procedure)."

(emphasis added).

294. With respect, that essentially conclusory analysis strikes me as improbable. Article 192 imposes important duties on a senior civil servant in respect of the entry into contracts, but on Professor Domenichelli's analysis, in an Article 42(2) case, the senior civil

servant's role would be limited to that of a mere scribe. It would place almost the whole burden of analysis and the implementation of the procurement process on individuals who would generally be ill-equipped to discharge it. And it would seem to impose burdens on the City Council in respect of "fundamental acts" which involved entry into contracts (for Article 192 has no other application) which would not apply to the many other classes of fundamental act, including those falling within Article 42(2)(i) itself which did not require a contract (for example a decision to make a grant to an opera company for three years).

295. *Cattolica* and subsequent authority apart, Professor Domenichelli's conclusion is only supported by rather generalised assertions:

i) First, that any contrary conclusion would be tantamount to a delegation or abrogation of the City Council's functions. However, the decision whether or not to give the approval, and subject to what conditions, would be a matter for the City Council, even if Article 192 only applied to executives.

ii) Second, that without such a restriction, the City Council would not have access to the quality of information they would need to be able to enter into a contract. However, even leaving aside the assumptions inherent within this analysis as to what information it is necessary for the City Council to have in order to enter into a binding contract, that does not dictate that any requisite knowledge must be held within one part of the internal governance structures of Venice (the City Council) rather than another (the civil servant in charge of the expenditure procedures), with the terms of Article 192 itself suggesting that the latter is the more obvious repository.

296. But what of *Cattolica*? As Venice observed in its opening submissions, *"Cattolica* did not expressly address Article 192 of TUEL". That omission must be viewed in the following context:

i) The argument that a City Council resolution on a matter falling within Article 42(2) which concerned the entry into a contract had to comply with Article 192 was clearly raised by the municipality before the Court of Appeal of Bologna. At [2.2] of its judgment, the Court of Appeal summarised one of the Municipality's arguments as follows:

> "It insists on the fact that …. the use of debt should have been resolved by the city council pursuant to Art 192 letter (b) (content of the resolution to contract) and [Art] 42, paragraph 2, letter)i).
>
> The Resolution passed on 27.03.2003 by the City Council preceding the first contract merely provides `guidelines' and *did not have the contents required by Art 192*".

(emphasis added).

ii) That conclusion was upheld by the Bologna Court of Appeal at [4.2]:

> "The initial council resolution … in no way identified the subject, form and content of the clauses considered to be essential, the methods for choosing

the contracting party pursuant to Art 192 of the Consolidated Law on Local Entities (which establishes the general competence of the manager but which must be considered applicable with regard to the content and as the appellant notes, even if the competent body differs".

iii) However, this was not a point which the First Civil Division referred to in the Interlocutory Order, and Article 192 was not referred to in its (substantial) list of "rules that are important in the context of the argument carried out".

iv) Neither the argument of the Municipality referred to at i) nor the decision of the Bologna Court of Appeal referred to at ii) appear in the Supreme Court's summary of the arguments and the prior findings. What does appear is the following at [10.4.1] (but without any attribution, or even reference, to Article 192):

> "The **city council** must evaluate the cost-effectiveness of transactions that may constrain the use of future resources and make clear that the local entity's transaction must follow the rules of public accounting that govern the carrying out of the responsibilities of entities that use public resources. *Therefore, if* **a Municipality** *wishes to enter into a debt restructuring transaction,* **it** *must identify its main characteristics and the means to implement it and then use a tender proceeding to choose the best offer in relation not only to the goal it seeks to achieve but also the methods it wants to use*, since the **public administration** must conform its actions to principles of affordability and economic cost-effectiveness*".*

The (added) italicised words clearly pick up the language of Article 192. But whereas the first sentence refers to what the *City Council* must do, the second sentence uses the potentially broader and more ambiguous terms "the Municipality" and "the public administration".

v) There is also the curiosity of where this passage appears in the judgment: as one of a number of factors cited "in support of the city council's choice", but not in the conclusory [10.6], [10.7] and [10.8]. As Cockerill J noted in *Busto*, [362], [10.4.1] of *Cattolica* "forms part of the lead up" to the legal principles the decision formulates, by way of a "backdrop". It seems improbable that an arrival of such significance should have appeared unnamed and unannounced at the side-door.

297. However, at least one decision following *Cattolica* – the decision of the Court of Venice Judgment Decision No 696/2022 – referred to a City Council resolution having failed to comply with Article 192.

298. In the event, I have not found it necessary to resolve the issue of whether Article 192 applies directly, or by analogy in its full force, to the resolutions of the City Council which relate to the entry into contracts. On any view, the Supreme Court did impose certain requirements in relation to the decision to enter into a derivative transaction which fell within Article 42(2)(i) because they constituted indebtedness (per *Cattolica*) due to the fact that the transaction involved the payment of an upfront:

i) The City Council was required to evaluate the cost-effectiveness of the recourse to indebtedness.

ii) The resolution must identify and approve the amount of the upfront (otherwise the City Council could not do what, on the Supreme Court's conclusion, it was obliged to do, namely approve the decision to enter into a derivative transaction which involved recourse to indebtedness).

iii) Implicitly, the Supreme Court upheld the Court of Bologna's decision that the resolutions of the City Council in that case were not sufficient, having earlier noted (at [2.5]) that the Court of Appeal had found that "the city council's resolution of 27 March 2003 provided a mere 'guideline' which was subsequently implemented by the City Board and by the head officer …." (and at [5.3]).

Did Resolution 129 Comply with the Requirements Established by *Cattolica*?

299. Resolution 129 was issued by the City Council on 25 September 2007. The relevant recitals referred to the proposed restructuring of the Rialto Bond "as well as the restructuring of the derivative transaction to cover the interest rate risk associated with the aforesaid issue". It noted the proposal was "of interest" to Venice. The resultant Resolutions were as follows:

> "7. to authorise the modification of the terms and conditions of the twenty-year variable rate debenture loan called "Rialto" issued in the form of private placement, ISIN code XS 0160255856, for a nominal amount of EUR 156,082,000.00 and in particular the modification of the margin on the interest rate applicable up to a maximum of 0.23% of the duration of the loan, which may be extended up to 2037, and of the amortisation plan (with reformulation of the principal amounts as per amortisation plan attached hereto);
>
> 8. to also authorise the restructuring of the existing derivative transaction in relation to the aforementioned loan in the most appropriate forms, including the replacement of the original counterparty with the banking institutions appointed as Co-arrangers, Co-consent Coordinators and Dealers indicated in the recitals in in relation to the transaction referred to in point 7 above), also proceeding to the drafting of the relevant ISDA contract, if applicable;
>
> 9. to authorise the Interdepartmental Directorate for Finance and Accounts to carry out all the acts consequent to this resolution, and in particular:
>
> a. the adoption of all acts necessary for the call of the debenture holders' meeting, also abroad, for the purpose of the resolution with which the modifications of the debenture loan of EUR 156,082,000.00 will be authorised, including the publication of the relevant notices in the newspapers and/or other forms of collective disclosure, as provided for by contract;
>
> b. the signing of the documents necessary to modify the terms and conditions of the debenture loan, in accordance with the decisions of the debenture holders' meeting;

c. the definition of the final terms and conditions of the debenture loan and, in particular, to authorise the determination of the margin on the interest rate applicable to the loan up to a maximum of 0.23% Euribor 6 months, the extension of the expiry date until 2037 and the approval of the relevant final amortisation plan, as well as authorising the execution of all the documentation necessary for such purposes, including the issue of a new payment delegation to replace or supplement the original delegation issued by the Municipality in relation to this loan;

d. the negotiation and execution of the documentation necessary for the restructuring of the derivatives transaction relating to the same debenture loan, in compliance with the provisions of Article 41 of Law no. 448/2001 and the related implementation provisions, including the ISDA documentation (Master Agreement and Schedule) with the new "Swap" counterparties referred to in point 8 above, as well as the definition of the final terms and conditions of these restructuring transactions".

300. I am satisfied that Resolution 129 does not meet the minimum requirements for a valid resolution of the City Council established by *Cattolica*. In particular, the Resolution did not authorise the entry into a transaction involving an upfront, still less identify or approve any upfront payment, or specify the amount of any such payment.

301. In short, the Resolution essentially took the form of a guideline which delegated agreement on the financial terms of the swap to the Finance Department. Indeed, the Banks appear to accept that, remarking in opening that "such approval could only be provided by way of a general guideline". However, it is sufficiently clear from *Cattolica* that that is not enough. I do not accept that it would have been impossible for the City Council to pass a Resolution which approved the main terms of the Transactions (and in particular the approximate amount to be paid to wind-up the Bear Stearns IRS, and the means by which this should be accommodated within the restructured transactions). This was not done by the City Council not because it was not possible to do it, but because in the Before *Cattolica* Era none of those involved understood this to be required. In any event, no principle of Italian law was identified which relieved the City Council of its decision-making responsibilities in circumstances in which it was difficult or impractical for it to exercise them, and any such argument would have run into the limited terms of the "expediency exception" in Article 42(4) of TUEL which provided:

> "The decisions on the matters referred to in this article may not be adopted urgently by other bodies of the Municipality or Province, except those relating to budget changes adopted by City and Province Boards to be submitted for ratification by City and Province Councils in the following sixty days, under penalty of forfeiture."

302. Finally, had I reached a conclusion in Venice's favour that the Resolution had to satisfy the requirements of Article 192, it plainly would not have done so.

Venice's Alternative Case

303. In the alternative, Venice contends that Article 192 applies to the decisions of the Executive Board and/or Mr Dei Rossi as the responsible person, and the requirements of Article 192 were not met in either case. In the light of my conclusion on:

i) the Speculation and Indebtedness Arguments at Sections I, J and K above;

ii) the insufficiency of the Resolution adopting the minimum requirements established by *Cattolica* at [298] above; and

iii) the characterisation of Venice's TUEL arguments at [304]-[316] below;

I have not found it necessary to resolve these arguments.

How are the Requirements Under Articles 42(2)(i) and 192 of TUEL to be Characterised as a Matter of English Conflicts of Law Analysis?

304. On the assumption which falls to be applied at this point (that Venice would have been able to enter into the Transactions had the City Council and/or Mr Dei Rossi resolved to do so in a manner complying with Article 192), the question which then arises is whether this falls to be categorised for English conflicts of law purposes as a matter going to Venice's capacity, or to the authority of Mr Dei Rossi who purported to sign the Transactions on Venice's behalf.

305. Mr Cox KC submits that these provisions form part of a statute specifically concerned with regulation of the powers of Italian local authorities, and, for that reason, they should be regarded as part of Venice's "constitution" just as s.50 of the Norwegian Local Government Act 1992 was part of the Norwegian kommune's constitution in *Haugesund*. However, the mere fact that a particular statute is the source of a limitation on the substantive power of a corporation does not mean that every provision in that statute is, as a matter of English conflicts of law analysis, a provision delineating the scope of the corporation's substantive powers for English law purposes. Were that to be the case, Article 124 of TUEL requiring local authority resolutions to be published on the council notice board for a set period would constitute a limitation on capacity for English law purposes. Similarly, company legislation, which will constitute part of the "constitution" of a company in the *Haugesund* sense, may well contain provisions which limit the substantive powers of the corporation and also provisions which limit the powers of its officers or management bodies to take decisions or act on its behalf. The mere fact that these provisions share the same statutory home does not mean that they share the same categorisation as a matter of English conflicts of law analysis.

306. On the face of things, Article 42(2)(i) is a provision which is not concerned with what Venice *can* do, but the analytically different question of which body or natural person can undertake the relevant act *on its behalf*: in short, a provision which goes not to the issue of what substantive powers Venice has, but how they are to be exercised. In *Law Debenture Trust Corp v Ukraine* [2017] EWHC 655 (Comm), on which the Banks relied, Blair J had to consider a provision of Ukrainian law preventing the state from entering into a debt transaction where this would have the effect of exceeding a "hard limit" set out in its budgetary law. Blair J held that this limit was one which, as a matter of English conflict of law principles, raised a question of authority rather than capacity, holding at [133]-[134]:

> "Applying the reasoning in the *Haugesund Kommune case* ... , para 47, it is not contended by Ukraine that it had no power to enter into a Eurobond transaction, having entered into a number of such transactions in the past. Its case is that it had no power to enter into this Eurobond transaction because it was outside the "hard limits" set out in the budget law. The law could have been amended by Parliament, but not retrospectively.
>
> However, the court accepts the Trustee's submission that this is not a case of lack of power, but of the power not being exercised as the law required. This is properly characterised as going to a lack of authority on the part of the actors concerned, and in particular the Minister of Finance, which is a different enquiry, with potentially different consequences ….".

The present case is, if anything, a stronger set of facts than those considered by Blair J. At least as a matter of Ukrainian law (which the Court of Appeal went onto hold was irrelevant when considering the capacity of a state: [2018] EWCA Civ 2026), the "hard limit" prevented Ukraine from entering into bond transactions for so long as the limit would be exceeded. By contrast, on the assumptions on which this part of the case is to be approached, Venice could enter into the Transactions at the relevant time, provided the City Council took the decision to do so in an appropriate manner.

307. At the forefront of Mr Cox KC's submission that the issue was one of capacity were the decisions of Popplewell J and the Court of Appeal in *Integral Petroleum SA v SCU-Finanz AG* [2014] EWHC 702 (Comm); [2015] EWCA Civ 144. In that case, it was alleged that a Swiss company had entered into a contract to sell oil to the claimant. On the evidence of Swiss law, the power to bind a company was held by one or more "prokurists" holding powers of representation on the company's behalf. However, it was open to a company to stipulate that only contracts signed by two prokurists would be binding on the company, which is what the seller had done in that case, and that requirement had been entered on the (publicly accessible) Swiss Register of Commerce. The contract of sale had been signed by only one prokurist, but it provided for the application of English law.

308. The buyer argued that the issue of whether a contract signed by only one prokurist was binding raised a question of material validity, which under Articles 10 and 11 of the Regulation (EC) No 593/2008 ("Rome 1") would have raised an issue of English law. The seller argued that the matters in issue were "questions of capacity governed by the company's constitution", the constitution to be interpreted by applying the "broad internationalist interpretation" required by *Haugesund,* and that they fell outside Rome I by virtue of Article 1(2)(f) and (g) which provide:

> "(f) questions governed by the law of companies and other bodies corporate or unincorporated, such as the creation, by registration or otherwise, legal questions governed by the law of companies and other bodies, corporate or unincorporated, such as the creation, by registration or otherwise, legal capacity, internal organisation or winding-up of companies and other bodies, corporate or unincorporated, and the personal liability of officers and members as such for the obligations of the company or body;

(g) the question whether an agent is able to bind a principal, or an organ to bind a company or other body corporate or unincorporated, in relation to a third party".

It will be noted that Article 1(2)(f) is not limited to questions of capacity in *Haugesund* terms, and that the seller's argument was not limited to Article 1(2)(f).

309. Popplewell J undoubtedly described the competing arguments as those of "capacity" and "validity", and there are passages in which he treats the former question as engaging (and only engaging) a question of capacity in the *Haugesund* sense. In particular, at [53] he stated:

> "In seeking to characterise the issue in order to identify the correct conflicts principle, the concepts of 'capacity' and 'validity' must be interpreted by reference to a broad internationalist approach, not by reference to any concepts of domestic law: see *Haugesund v Depfa* at [47]. 'Capacity' is often used to convey the concept of whether someone can do something as a matter of physical or legal capability. For natural persons it may connote legal capability determined by reference to age or infirmity. For legal persons it may connote legal capability by reference what the objects or powers of a company or public body enable it to do. Even in such sense, it may have a wider connotation in its application to domestic law concepts than merely the inherent ability to enter into a particular type of transaction. It covers both the narrower and the wider sense in which the expression "ultra vires" is used in English law (see the classic passage in the judgment of Slade LJ in *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* [1986] Ch 246 at 276-278). In this respect questions of a "power" under a company's constitution are categorised as questions of capacity just as are those which govern its legal ability to enter into a transaction of a particular type: see *Haugesund v Depfa"*.

310. However, on closer inspection, it is clear that Popplewell J was using the expression "capacity" as a short-hand to embrace two questions, both of which fell to be determined by reference to the company's constitution: whether there was lack of legal capability on the corporation' part, and whether, under the constitution of the corporation, the particular officer had actual authority to commit it to a contract (for a similar usage see Males J in *UBS AG v Kommunale Wasserwerke Leipzig GmbH* [2014] EWHC 3615 (Comm), [529]).

311. I have reached that conclusion for the following reasons:

i) As I have noted, the seller's argument embraced both Article 1(2)(f) and (g).

ii) At [54], Popplewell J contrasted validity (concerned with matters "intrinsic" to the contract) with extrinsic matters "relating to the power or authority of those making the contract".

iii) His citation, at [56], of the celebrated passage of Lord Hoffmann's judgment in *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500, 506 with its reference to a company's "primary rules of attribution" which are "generally found in its constitution" and "general rules of attribution" (which I will refer to as **secondary rules of attribution**) such as agency, estoppel,

ostensible authority and vicarious liability. Popplewell J then referred to the issue in the case before him as "one of attribution" ([57]) which he said was "concerned with *the power or authority* of natural persons to make their acts the acts of the company", which turned on "the rules contained in a company's constitution, supplemented by rules of agency". He said that this question:

> "is properly to be characterised as engaging the conflicts principles governing capacity, insofar as the constitution of the company, in its broad sense, contains the rules as to what acts are to be attributed to the company; and the conflicts principles governing agency, insofar as the rules of agency supplement the rules in the company's constitution for the purposes of attribution".

In my view, it is clear from this passage that Popplewell J is using the word "capacity" to refer to the primary rules of attribution as set out in the company's constitution (interpreting that word in its *Haugesund* sense), both when they define the capacity of the company and when they define the authority of the company's officers and organs.

iv) In particular, Popplewell J was making it clear that the question of whether a corporation's officers or organs had power to commit the corporation in a particular respect was (as a matter of English law conflicts analysis) a matter for the law of the place of incorporation ([59]) rather than, as in some other contexts, a matter for the applicable law of the agency relationship (see in particular the citation from *Dicey, Morris & Collins* at [62]). However, he noted that, had the issue been approached by applying the general conflict principles applicable to agency questions, Swiss law would also have applied ([61]).

v) It was precisely because Popplewell J did not regard himself as dealing with a question of corporate capacity properly so-called, but the primary rules of attribution in relation to a company, that he went on to consider an alternative argument by reference to a secondary rule of attribution (ostensible authority): an issue which could never have arisen had the absence of two signatures raised a question of capacity in the *Haugesund* sense. The ostensible authority argument was rejected because it was not arguable on the facts ([63]).

312. Turning to the Court of Appeal, they too referred to both Articles 1.2(f) and (g) of Rome 1 ([22] and [46], where they are linked by "and/or"). In summarising the issue raised by the seller, Floyd LJ noted at [27] that "SCU … relies on Rule 175 in *Dicey*. Rule 175 is concerned with the capacity of corporations to enter into transactions as well as matters concerning the constitution of a corporation", that summary correctly observing that *Dicey* dealt with issues of corporate capacity properly so-called and primary rules of attribution of the acts of a company's officers in the same article, because they both depended on a company's constitution. The use of the expression "capacity" to embrace both of those questions is made clear in the summary of the seller's submissions at [37]:

> "SCU submits that the issue to be decided is whether CU can contract by means of the signature of a single prokurist. This is a question of the company's 'capacity' governed by its constitution, *or more accurately whether the acts of a single prokurist can be attributed to SCU"*.

Later, the seller contrasted the case at hand with one where “no question of authority or attribution arises” ([38]).

313. Unsurprisingly, Floyd LJ’s judgment adopts that analysis. Thus at [39] he described the issue as “one of the authority of a single prokurist to bind the company”, at [40] he contrasted the position of a company with one of an individual where “questions of … authority” will not arise and noted that “a company can only act through natural persons *duly authorised to act on its behalf* and its ability to express its will is limited by *the authority of those representing it”*. The clear effect of those passages is not undermined, in my view, by the reference Floyd LJ makes to the comparison made by Jackson LJ in argument, when addressing the different reasons why two signatures might be required on a document, to “a person under disability who may require the signature of a mentally capable party to create an enforceable legal obligation” (at [43]). If there was any doubt about that, it is removed by Floyd LJ’s conclusion at [45]:

> “A sole prokurist has no actual authority to bind the company”

and his formulation of the issue at hand as being “whether an officer or agent is authorised to act on behalf of a company” ([47]).

314. In this case too, I am satisfied that:

i) the issue before the court is whether the act of Mr Dei Rossi in purporting to enter into the Transactions “can be attributed to” Venice;

ii) it is necessary to look at Venice’s constitution in the *Haugesund* sense to answer that question, as Mr Dei Rossi is an officer of a legal person and was acting in that capacity;

iii) doing so, the answer is no for the reasons set out at [298] to [301] above; but

iv) this does not exclude arguments by reference to secondary rules of attribution, including, in particular, the doctrines of ostensible authority and ratification under English law.

315. That conclusion is consistent with the conceptual distinction between issues of capacity and authority as outlined by Lord Leggatt in *SR Properties*, [24] (set out at [111] above). It also accords with the general “sense test” that where the complaint is not that a corporation was unable, on the basis of decisions of internal organs alone, to do a particular act, but that the wrong organ made the decision, or that it did so in a defective way, the issue which arises is properly categorised as one of authority, not one of capacity.

316. Finally, Mr Cox KC relied on the fact that, as a matter of Italian law, the consequence of the fact that the decision to enter into the Transactions was not taken by the City Council as a matter of Italian law was they were void, and not voidable, and that this was a point which was of sufficient import under Italian law that a court was permitted to take the point of its own motion. As to the position under Italian law:

i) I accept that the Supreme Court in *Cattolica* found that the consequence as a matter of Italian law of the lack of approval by the City Council in the required

form was that the resultant contracts were void, not merely voidable: [10.6] and [10.8] both state the contract must be authorised by the City Council "on penalty of voidness".

ii) I also accept that this represented something of a significant legal innovation. The Berti Article, 34 accepted that "according to the more traditional approach, the absence – or the existence of a radical defect – of the authorisation of a contract gives rise to a cause of action for the *annulment* of the negotiation …" (the view put forward by Professor Torchia), albeit Berti claims that there were rival theories, including an analysis by which the transaction would be ineffective unless and until adopted by the appropriate decision-maker.

iii) I am not persuaded that the conclusion in *Cattolica* that lack of appropriate City Council approval renders a contract void as a matter of Italian law is so obviously untenable that I should conclude that it does not properly reflect Italian law. It would appear that different views had been expressed as to the consequence of non-compliance with Article 42(2) of TUEL. Further, the decision in *Cattolica* in this respect has been followed in a number of subsequent cases: Court of Appeal of L'Aquila Decision No 576/2021; Court of Appeal of Rome Decision No 6894/2021; and the Court of Auditors of the Lazio Region in Decision No 42/2022 (the first two of those cases confirming that the court can take the point of its own motion).

317. However, consistently with the position in *Haugesund*, [60], having categorised Articles 42 and 192 of TUEL as provisions which do not establish the substantive power of Venice as a matter of English conflicts of law analysis, but relate to the ability of particular bodies or individuals to act on Venice's behalf, in my view the consequences of that lack of ability on an English law contract are to be determined under English law. In the present context, the consequence is to preclude actual authority on Mr Dei Rossi's part but leave room for the operation of the doctrines of ostensible authority and ratification.

Did Mr Dei Rossi have Ostensible Authority to Enter into the Transactions on Venice's Behalf?

318. In closing, Mr Cox KC accepted that if the analysis reached this point, then Mr Dei Rossi did have ostensible authority to commit Venice to the Transactions. That concession was rightly made, and inevitable on the evidence.

Did Venice Ratify the Transactions?

319. Venice advanced two reasons why it has not ratified the Transactions:

i) It did not know that Mr Dei Rossi lacked capacity until *Cattolica*; and

ii) The acts of ratification relied upon were too equivocal.

320. I intend to deal with these arguments briefly.

321. Venice's first argument vividly demonstrates quite how radical the Supreme Court's decision on Articles 42(2) and 192 of TUEL was. However, I do not accept that it

provides an answer to the plea of ratification. Venice knew each of the facts now relied upon to suggest that Mr Dei Rossi lacked authority:

i) what the City Council had and had not done and the terms of its Resolution;

ii) the terms of Mr Dei Rossi's Executive Resolution; and

iii) the terms of the Transactions (including that the floor had been set to address the significant adverse mark-to-market in the Bear Stearns IRS and, in due course, the negative MTM on the Transactions);

and yet was content to stand by the Transactions, provide for them in their annual financial statements for every year from 31 December 2007 onwards and perform the Transactions without reserve until the *Cattolica* decision emerged in May 2020. It has been held that it is not necessary for a principal to know that its agent acted without authority to ratify a transaction (*Brown v Innovatorone Plc* [2012] EWHC 1321 (Comm), [856]; *Ing Re (UK) Ltd v R&V Verisherung AG* [2006] EWHC 1544 (Comm), [153]-[156] and *Busto*, [383]). That conclusion applies with even greater force in a context such as the present, in which the principal comes to acquire a different legal understanding of the scope of the documents or regulations determining the agent's actual authority as a result of a legal decision handed down many years after the transaction is entered into.

322. So far as the second argument is concerned, Venice has complied with the terms of the Transactions from the effective date of 23 December 2007, paying all amounts due without any form of reservation until a letter sent on 18 December 2020 (itself 7 months after *Cattolica*). It received and has retained (admittedly small) payments in June and December 2008. It has repeatedly approved financial statements which accounted for the Transactions (albeit in non-specific terms). Further, the City Council approved the 2007 and subsequent budgets which included notes analysing the Transactions and setting out their current MTM value. Finally, on 21 June 2019, Venice commenced proceedings against the Banks in Italy premised on the Transactions remaining valid and binding and constituting a source of ongoing loss to Venice.

323. Had the point arisen, therefore, I would have been satisfied that Venice had ratified the Transactions.

M WERE THE TRANSACTIONS VOID FOR COMMON MISTAKE BECAUSE THE BEAR STEARNS IRS WAS INVALID?

324. By way of a further argument, Venice argued that (applying English law as the applicable law of the Transactions) the Transactions were void because they were entered into under the common mistake that the Bear Stearns IRS was valid whereas it was invalid because it had not received the required approval from the City Council or Mr Dei Rossi under Articles 42(2)(i) and 192 of TUEL. I shall refer to this as the **Mistake Argument**.

325. Clearly the Mistake Argument would only add value to Venice's case in these proceedings if there were circumstances in which the Transactions were otherwise valid and binding, but the Bear Stearns IRS was invalid. Mr Field (who presented Venice's oral submissions on this issue) identified two respects in which it was theoretically

possible for the Bear Stearns IRS to be invalid, but the Transactions (common mistake apart) to be valid:

i) The first and second amendments to the Bear Stearns IRS by confirmations dated 17 April 2003 and 6 August 2004 were not the subject of City Council resolutions at all, but only resolutions by Mr Dei Rossi.

ii) The Resolutions of Mr Dei Rossi in relation to the Bear Stearns IRS and both amendments post-dated the date when the confirmations were signed:

a) In relation to the original Bear Stearns IRS of 31 December 2002, Mr Dei Rossi's resolution was signed on 11 February 2003.

b) In relation to the first amendment of 17 April 2003, Mr Dei Rossi's resolution was signed on 21 May 2003.

c) In relation to the second amendment of 6 August 2004, Mr Dei Rossi's resolution was signed on 10 September 2004.

At first blush, the second of those two contentions appears to be a particularly unpromising argument.

326. However, in respect of the Article 42 TUEL Argument, Venice is in a more difficult position in seeking to challenge the Bear Stearns IRS than in relation to the Transactions, because there was no upfront payment. Accordingly, it would, on my interpretation of *Cattolica*, be necessary to establish that the negotiation of the Bear Stearns IRS entailed the termination, or a significant modification, to the underlying indebtedness. However, Venice's only case in this regard was limited to the interpretation of *Cattolica* which I have rejected – that all derivative transactions required City Council approval.

327. That leaves its arguments in relation to the inadequacy of Mr Dei Rossi's resolutions. On this hypothesis:

i) Venice does not have the benefit of any finding in *Cattolica* that non-compliance by an executive officer with the requirements of Article 192 (as opposed to non-compliance by the City Council with the requirements of Article 42(2)(i)) rendered the Bear Stearns IRS or the amendments not simply annullable but void. The terms in which the Supreme Court in *Cattolica* addressed the consequences of non-compliance with Article 42(2)(i) – at [10.2], [10.4], [10.4.1], [10.4.2], [10.5] and [10.8] – do not lend any obvious support to the view that the same consequence would follow from a breach by an executive officer of Article 192 (as opposed to what Berti had referred to as the "more traditional" annulment approach for which Professor Torchia contended). The decision of the Court of Venice in Decision No 696/2022 on which Venice relied in this respect, albeit referring to Article 192, was addressed (like *Cattolica*) to the consequences of a defective decision of the City Council, not an executive officer.

ii) In relation to the first and second amendments, even leaving aside the issue of whether the amendments were sufficient to constitute "significant modifications" for the purposes of *Cattolica*, there is the further difficulty that Venice's common

mistake case would become significantly more difficult if the mistake was not as to the existence of the Bear Stearns IRS, but only as to its terms to the extent amended by those amendments. Indeed, it does not appear to me that Venice had advanced a common mistake in a scenario in which the original Bear Stearns IRS was valid, but the first and second amendments were not.

328. These matters do not bode well for the prospects of the Mistake Argument riding to the rescue if the direct attacks on the Transactions had failed. Further, given my conclusions in relation to the categorisation of Articles 42(2)(i) and 192 of TUEL, I find it very difficult to see how these arguments could assist Venice in circumstances in which its primary challenges to the Transactions had failed (a conclusion which, in my view, applies with even greater force to decisions of an executive officer under Article 192, which on my assessment is the only aspect of the Mistake Argument left open to Venice on the pleadings and in the light of my prior determinations).

329. If Article 192 of TUEL is to be categorised as an issue of authority rather than capacity as a matter of English conflicts of law analysis (as I have found), then I did not understand Venice to contend that Mr Dei Rossi did not have ostensible authority to sign the Bear Stearns IRS and the two amending confirmations or that Venice had not ratified his acts in doing so. In any event:

i) I am satisfied that Venice held out Mr Dei Rossi (who on the evidence was the primary point of contact for Bear Stearns in relation to the Bear Stearns IRS) to Bear Stearns as having authority in relation to the decision to enter into and otherwise deal with the Bear Stearns IRS just as it held him out to the Banks in relation to the Transactions. Given the very late stage at which Venice raised the Mistake Argument, and the understandable deficiencies in Venice's disclosure in relation to a transaction originally entered into with a non-litigating party 20 years ago, I have concluded that I am entitled to infer that Venice provided Bear Stearns with a copy of City Council Regulation 194 which delegated authority to Mr Dei Rossi's department, and other documents sufficient to establish Mr Dei Rossi's authority to sign the Bear Stearns IRS and the two amending confirmations, and that Bear Stearns relied on the same.

ii) The Bear Stearns IRS was performed by Venice, accounted for in Venice's budgets and ultimately novated by Venice 6 years after it had been entered into on a basis which wound the Bear Stearns IRS up, without any suggestion that it was not valid. Any deficiency in Mr Dei Rossi's authority was clearly ratified by Venice.

330. In these circumstances, I do not propose to trespass on the interesting debates as to the correct test for common mistake, or whether the operation of the doctrine had been excluded in this case by a clear allocation of risk to one of the parties.

N DID THE TRANSACTIONS FAIL TO COMPLY WITH MANDATORY RULES OF ITALIAN LAW?

Introduction

331. Venice contends that the Transactions contravened the following rules of Italian law:

i) Article 3 of Decree 389 issued by the MEF pursuant to Article 41(1) of Law 448 of 2001, and of the 2004 MEF Circular issued by the MEF by way of guidance in the interpretation of Decree 389.

ii) under Articles 42(2)(i) and 192 of TUEL setting out the requirements for the conclusion of a valid contract under Italian law, and in particular the requirements of *oggetto* and *causa*;

which result in the Transactions being void and/or unenforceable.

332. It contends that these provisions of Italian law apply because they have the status of mandatory rules of Italian law for the purposes of Article 3(3) of the Rome Convention. There is also a footnote in Venice's closing argument which provides:

> "Venice also advances a case to the effect that the parties chose Italian law to apply to aspects of the Transactions and so the mandatory rules (and indeed all other rules) of Italian law applied to the Transactions for that reason, as to which see Section L".

333. Section L addresses Venice's counterclaim for damages for breach of non-contractual obligations owed by the Banks to Venice, if (contrary to Venice's primary case) the Transactions were binding. That section suggests only that there was an agreement that Italian law was "applicable to Venice's claim for damages for breach of non-contractual obligations" (paragraph 384(a), 386 and 400 of Venice's closing).

334. Venice's Defence and Counterclaim pleads that what were described as the Italian Regulatory Laws applied to "the presentation of the Transactions" rather than to the Transactions themselves (DCC, [9(c)]). Paragraph 39(w) pleads that "the law applicable to the Transactions was (i) the Italian Regulatory Laws in relation to the Presentations and (ii) otherwise English law."

335. If Venice was seeking to argue in closing that what it terms the Italian Regulatory Laws applied not simply to claims arising in the pre-contractual phase (for misrepresentation, failure to advise, the presentation of unsuitable transactions), but that it was agreed by the parties that there were one of two applicable laws which determined the applicable law of the Transactions under Article 3(1) of the Rome Convention, this point would have had to have been pleaded and the subject of clear argument. In the absence of either, I am satisfied that the footnote quoted in [332] above was not an attempt to advance such a case, and that the reference to Italian law applying to "some aspects of the Transactions" was simply to highlight the fact that Venice did not accept its claims arising during the pre-contract period for damages for breach of non-contractual obligations were governed by English law.

336. Article 3(1) of the Rome Convention provides for a contract to be governed by the law chosen by the parties. However, Article 3(3) provides:

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

337. The first (and threshold) question which arises in relation to this aspect of Venice's case is whether Article 3(3) is engaged.

Is Article 3(3) of the Rome Convention Engaged?

338. The issue of whether a swap transaction between an Italian local authority and an Italian bank engaged Article 3(3) was addressed by the Court of Appeal in *Dexia Crediop SpA v Comune di Prato* [2017] EWCA Civ 428. At [121], Longmore LJ (delivering the judgment of the court) observed that "the critical question, therefore, is whether, apart from the ISDA law and jurisdiction clause 'all the other elements relevant to the situation are connected with one country only'." At first instance, Walker J had found that all the elements of the swaps were connected with Italy, in particular having regard to the identity of the parties, the place where they had dealt with each other and the place of performance of the contractual obligations. However, in *Banco Santander Totta SA v Companhia Carris* [2016] 4 WLR 49, a case concerning a swap on ISDA terms between Portuguese parties, Blair J held that the swaps in that case did not fall within Article 3(3) of the Rome Convention because of the following "international" elements:

i) The fact that the bank had the right to assign the swap to a bank outside Portugal.

ii) The 'practical necessity' for a relationship between the investor and a bank outside Portugal.

iii) The use of standard international documentation (the ISDA Master Agreement).

iv) The international nature of the swaps market in which the swaps were concluded.

v) The fact that the bank had entered into "back-to-back" hedging contracts with a bank outside Portugal in circumstances in which such hedging contracts were routine.

339. The Court of Appeal approved Blair J's analysis both of the types of elements which were relevant to the Article 3(3) issue and the significance of the factors he had identified. At [131], Longmore LJ stated:

> "The present case, is, of course, distinguishable in as much as the swap contracts with which this court is concerned did not contain any specific right to assign the contract to a bank outside Italy and there was no 'practical necessity' for a relationship between the investor and a bank outside Italy but two of the other three elements, considered by Blair J to be important, are present namely the use of standard international documentation, in the form of the ISDA Master Agreement and the routine back-to-back contracts concluded with banks outside Italy. The third element, the international nature of the swaps market in which contracts were concluded, is perhaps somewhat less obvious in this case than in *Banco Santander* ."

340. On the facts of that case, Longmore LJ stated:

i) The contract was on the ISDA 'Multi-currency – Cross Border form' rather than the 'Local Currency – single Jurisdiction form' and thus contemplated more than

one currency and the involvement of more than one country. The form signed by the parties was in the English language, despite that not being the first language of either party ([132]).

ii) The back-to-back arrangements made with banks outside Italy were routine and therefore (objectively) foreseeable, reflecting how international the swaps market was ([133]).

iii) Each of those factors was "enough on its own to demonstrate an international and relevant element in the situation such that it is impossible to say that 'all elements (other than the choice of law) relevant to the situation' are located in a country other than England such as (in this case) Italy", continuing:

> "The international dimension precludes any such assertion. The use of the ISDA Master Agreement is self-evidently not connected with any particular country and is used precisely because it is not intended to be associated exclusively with any such country",

([134]), with the presence of "back-to-back" contracts being "highly significant" ([35]).

iv) The fact that non-Italian banks had tendered for the original advisory contract ultimately made with Dexia was also "a relevant element" ([136]), but in the nature of "icing on the cake" in view of the other factors.

v) Once an international element comes into the picture, Article 3(3) with its reference to mandatory rules should have no application ([137]).

341. Applying that guidance in this case, it is clear beyond argument that these were not Transactions in which all the elements other than the choice of law (accompanied by a choice of forum) at the time of contracting were connected only with Italy:

i) Beginning chronologically with the icing rather than the cake, non-Italian banks (Citigroup, Deutsche Bank, UBS, Barclays with another non-Italian bank, Depfa Bank also participating) were invited to tender for the swap transactions which Venice wished to explore.

ii) The Transactions were on standard international documentation, in the form of the 'Multi Currency-Cross Border form' ISDA Master Agreement (although it should be noted that while the Venice Master Agreement and Schedules were executed in English, the Confirmation was in Italian and expressly referred to the application of certain Italian regulatory provisions to specified activities in the pre-contract phase). While these were single currency swaps in Euros, the Euro is an international currency and one of the key currencies of the international swaps market.

iii) It was objectively foreseeable, given their routine nature, that one or both of the Banks would enter into a back-to-back hedging contract with a bank outside Italy. Dexia entered into a contract with Barclays Bank in London hedging its exposures under the Transactions. While Banca Opi hedged its transactions with another (Italian) bank in the Intesa Sanpaolo Group (which is an international group), that

does not affect the routine and objectively obviously foreseeable prospect of banks entering into back-to-back swaps in the international swaps market in respect of contracts such as the Transactions.

iv) Very significantly, the Transactions were entered into as part of a package which involved the transfer of the Bear Stearns IRS to the Banks as part of a mechanism to wind that transaction up. Not only, therefore, was an important aspect of the arrangements of which the Transactions formed part an international swap transaction (on the same ISDA form) between Venice and the Irish affiliate of a New York bank, but the Transactions were entered into as part of a package which included a three-way contract between Venice, the Banks and that US bank. Venice had no answer to this point, which made this a much stronger case than *Prato*.

342. For these reasons, Venice's case in reliance on mandatory laws fails at the first hurdle. In these circumstances, I do not intend to address the remaining issues at any length but limit myself to some brief observations.

MEF Regulation No. 389 and the 2004 MEF Circular

343. There was no dispute that MEF Regulation No 389 amounted to a mandatory Italian law. However, the question of whether MEF Regulation No 389 was breached was very much in issue.

344. I have set out the terms of MEF Regulation 389 and the 2004 MEF Circular at [136] and [140] above. It will be recalled that Regulation 289 permits local authorities to purchase "an interest rate collar in which the buyer is guaranteed an interest rate to be paid, fluctuating within a pre-determined minimum and maximum" and the 2004 MEF Circular provides that:

> "Implicit in the purchase of the collar is the purchase of a cap and the simultaneous sale of a floor, *which is permitted solely for the purpose of financing the protection against rising interest rates provided by the purchase of the cap*."

(emphasis added).

345. Venice argues that the effect of the italicised words is that, when a collar is purchased, the MTM of the floor at the point of purchase cannot exceed the MTM of the cap. That argument has been conspicuously unsuccessful in the English courts to date:

i) It was comprehensively rejected by Christopher Clarke LJ in *Regione Piemonte v Dexia Crediop Spa* [2014] EWCA Civ 1298 (see [158]), on the basis that there was nothing in Decree 389 itself to support such a restriction, and because of the practical difficulties of ensuring that the MTM of the floor and the cap were evenly matched (*Piemonte*, [75]), noting that the 2004 MEF Circular was simply guidance in any event.

ii) It was rejected once again by Walker J in *Dexia Crediop S.p.A. v Comune di Prato* [2015] EWHC 1746 (Comm), based on an interpretation of Decree 389 and the 2004 MEF Decree (*Prato*¸ [186]-[187].

iii) It was also rejected by Cockerill J in *Busto*, [312]-[316] for essentially the same reasons, albeit the issue had not been pleaded or the subject of expert evidence before her.

346. Essentially the same arguments (interpretation, the status of the 2004 MEF Circular and the practical consequences of Venice's interpretation) were relied upon by the Banks before me.

347. So far as the interpretation of the 2004 MEF Circular is concerned, there is something to be said for both sides of the argument. If the only reason the floor has been sold is for the purpose of acquiring the cap, then I can see how it can be said that the purpose of selling the floor is to finance the cap, even where the floor is sold for a greater amount than is paid for the cap. A down-on-their luck aristocrat who sold an Old Master to meet their tax bill could say with complete accuracy that the Old Master had been sold solely for the purpose of financing the tax bill, even if the price received exceeded the amount of their fiscal liability. However, particularly if supported by teleological considerations, it is possible to read the language – and in particular the word "finance" – as requiring a measure of equivalence between the two values. Whereas the down-on-their luck aristocrat has the binary choice of selling the Old Master or not doing so, there are (in theory at least) a variety of possible floors available to the local authority who wishes to acquire a cap, each with their own value.

348. In relation to that issue, and the significance to be attached to a failure to adhere to the MEF 2004 Circular on Venice's interpretation of it, it is right to note that the clear trend of Italian court decisions had been in favour of the conclusions rejected by Christopher Clarke LJ, Walker J and Cockerill J, in two decisions of the Court of Appeal of Milan (Decisions Nos 2017/2052, 2018/4712 and 2020/2393 each upholding decisions to the same effect at first instance), a decision of the Court of Appeal of L'Aquila (Decision No 576/2021 upholding a decision to the same effect at first instance) and a decision of the Court of Venice (Decision No 696/2022). It may at some point be necessary to determine whether there are sufficient swallows here to herald the arrival of summer.

349. So far as the practical arguments are concerned, the Banks pointed to a number of unrealistic or commercially absurd consequences which it was said would follow from a requirement that when a local authority purchased a collar swap, the value of the floor and the cap had to match:

i) It would require the parties to undertake complex valuation exercises using assumptions and models, in circumstances in which the valuation of a floor and cap is not an exact science but a subject on which different views could reasonably be held.

ii) Banks are unlikely to be willing to disclose their proprietary models in order to enable the counterparty to satisfy itself of the methodology for arriving at the value.

iii) Issues would arise as to the timing of the calculation of equivalence, given the risk of intra-day market movements.

iv) The approach would offer no scope for a bank to cover its costs (including its costs of hedging), give it a return for assuming counterparty risk and to make a profit on the transaction.

350. I would note in relation to these submissions that, for understandable forensic reasons, the Banks chose to characterise Venice's interpretation as one which "requires the value of the cap and floor elements to be identical" or required "a perfect symmetry" between the two. The application of the MEF 2004 Circular to a case such as the present – in which the very significant difference between the value of the floor and the cap was largely driven by the desire to cover the cost of winding up the Bear Stearns IRS – might raise different issues.

Article 1322 and 1325 of the ICC

351. Venice's argument that these provisions of the Italian civil code constituted mandatory provisions of Italian Law was raised at a very late stage, but I gave Venice permission to advance this argument at the start of the trial. The issue received very little consideration thereafter and was not addressed in the oral evidence.

352. By way of a reminder:

i) Article 1322 provides:

> "The parties can freely determine the contents of the contract within the limits imposed by law.
>
> The parties can also make contract that are of not of the types that are particularly regulated provided that they are directed to the realization of interests worthy of protection according to the legal order".

ii) Article 1325 provides that:

> "The requisites of the contract are:
>
> 1) Agreement of the parties.
>
> 2) Causa.
>
> 3) Object.
>
> 4) Form, when prescribed by law, under penalty of nullity".

iii) Article 1418(2) provides that the absence of any of these elements renders a contract void.

353. The evidence of Professor Gentili was that the parties could choose a different law to govern their contract under a legal system which did not contain Articles 1322 and 1325, and that Italian courts would give effect to that choice provided that that system provided broadly equivalent safeguards.

354. The issue of whether the rules set by one legal order as to what is necessary to create binding contractual obligations under its system of law constitute mandatory rules of

law applicable under Article 3(3) of the Rome Convention (so as to apply even in the face of a choice of different governing law when the requirements for the application of Article 3(3) are otherwise met) is a matter of real significance. Given the limited evidence and submissions which I received on the topic, and its wholly contingent nature, I have decided not to determine it.

355. I would note that different legal systems often impose different requirements for the conclusion of a binding contract, with the requirements imposed by the Italian legal system including Articles 1322 and 1325 of the ICC. However, I am not sure how helpful it is, as Venice did, to describe Articles 1322 and 1325 "as non-derogable in a contract governed by Italian law". If the law of contract of Ruritania imposes three requirements for a binding contract, then by definition it is not possible to conclude a contract which is binding under that system of law in the absence of any one of them. All such requirements are, by definition, "non-derogable".

356. I am conscious that the suggestion that the doctrine of consideration is a mandatory rule of English law for Article 3(3) purposes has very distinguished support from Professor Briggs, *Private International Law in English Courts* (2014), [7.118] and from Lord Collins of Mapesbury in *Dicey, Morris and Collins on the Conflict of Laws* (15th) [32-105], illustration 1. If that is true of consideration, it would seem to follow that the doctrine of privity of contract in the era before the Contracts (Rights of Third Parties) Act 1999 would also have been a mandatory rule of English law (at least on the interpretation that the privity doctrine resulted from a requirement that consideration move from the promisee).

357. The consequence of a rule that all the "power conferring" requirements under the law of contract in a particular jurisdiction for the creation of contractual obligations binding under that law constitute mandatory rules of law for Article 3(3) purposes might be very significant. It is not uncommon for parties transacting in a context where all the elements of the contract (choice of law apart) are only linked to one country to choose English law to govern their transaction. It might be said to involve a serious limitation on the right of contracting parties to choose the law governing the material validity of their contractual relations under Article 3(1) of the Rome Convention (a choice which might be made precisely because different legal systems impose different sets of legal requirements for the creation of contractual obligations). I can see that there may be scope, in this context, for distinguishing between the pre-requisites to the conclusion of a binding contract under a particular legal order depending on whether or not they exist to serve a particular public policy. In a case in which the argument does arise for determination, it will require very careful consideration.

O IS VENICE ESTOPPED FROM CONTENDING THAT THE TRANSACTIONS ARE VOID?

358. If (as I have found) Venice lacked the substantive power to enter into the Transactions as a matter of Italian law, with the result that the Transactions are void as a matter of English law, the Banks argue that Venice is estopped from contending that the Transactions are void by reason of contractual estoppels set out in the Venice Master Agreement as follows:

i) By Section 3(a)(ii), that it has and had the power to execute the Transaction Documents and any other documentation relating to the Transaction Documents

that it is required to deliver and perform its obligations under the Transaction Documents and has taken all necessary action to authorise such execution, delivery and performance.

ii) By Section 3(a)(iii), that such execution, delivery and performance does not and did not at any material time violate or conflict with any law applicable to Venice, any provision of its constitutional documents, any order or judgment of any court or other agency of government applicable to it or any of its assets or any contractual restriction binding on or affecting it or any of its assets or any contractual restriction binding on or affecting it or any of its assets.

iii) By Section 3(a)(v), that the obligations of Venice under the Transaction Documents as well as under all other written agreements and/or written notifications and/or documents entered into and/or executed pursuant to the Transaction Documents, constitute its legal, valid and binding obligations, enforceable in accordance with their respective terms.

iv) There was an additional representation:

> "Non speculation. This Agreement has been and the Transaction hereunder will be (and, if applicable, has been) entered into for purposes of managing its borrowings or investments and not for purposes of speculation".

I have here isolated the particular references pleaded in paragraph 23 of the Banks' Particulars of Claim, to which compendious reference is made in the Banks' written submissions, which appear of potential relevance to this argument.

359. This argument was dealt with very briefly at trial. The sum total of the Banks' submissions on this issue in opening and closing were contained within a page, although the argument was addressed at greater length by Venice. In the section in its trial skeleton addressing the estoppel case, the Banks placed particular reliance on section 3(a)(v) of the Venice Master Agreement.

360. At first impression, the Banks' argument is a rather improbable one: we have it on the authority of both Parmenides and Rogers and Hammerstein that nothing comes from nothing. However, the Banks argue that the Venice Master Agreement is a separate contract from the Confirmation entered into within the framework of that contract, such that matters which have the effect that the Confirmation is void and unenforceable do not extend to the former. I accept that there will be contexts in which the ISDA Master Agreement setting the framework of the parties' relationship, and the confirmations recording the terms of individual transactions entered into within the framework, will live separate lives, and where a fatal impugning of the latter will not necessarily injure the former. As Hildyard J noted in *Re Lehman Brothers International (Europe) (in administration) (No 8)* [2016] EWHC 2417 (Ch), [30(1)], "the ISDA Master Agreements provide contractually agreed standard terms and conditions which are designed to form part, but not the whole, of the terms of any particular transaction. Their purpose is to set out provisions governing the parties' relationship that are not transaction specific."

361. One consequence of this is that there can be circumstances in which a particular transaction is void, but the Master Agreement is not (*Firth on Derivatives Law and*

Practice, Looseleaf [11.038]). This will frequently be the case when the ISDA Master Agreement is entered into in anticipation of a course of trading, with a number of separate transactions subsequently being entered into within that framework agreement over a period of time. I was not persuaded that the "Single Agreement" clause in the ISDA Master Agreement compels a different construction in such a scenario:

> "(c) **Single Agreement** All Transactions are entered into in reliance on the fact that this Master Agreement and all Confirmations form a single agreement between the parties (collectively referred to as 'this Agreement'), and the parties would not otherwise enter into any Transactions".

That cannot have the effect, in a case in which the parties seek to enter into a number of swap transactions within the framework of the ISDA Master Agreement, they will always all stand or fall together. *Credit Suisse International v Stichting Vestia Groep* [2014] EWHC 3103 (Comm) is one of a number of cases which are inconsistent with any such suggestion. Nor can I accept that (for example) the setting aside of a particular swap because it was induced by misrepresentation necessarily impugns the Master Agreement and the other transactions entered into within the framework it established. I accept, however, that in a case such as the present where the ISDA Master Agreement and a single Confirmation are entered into at the same time for the sole purpose of executing the latter transaction, they constitute in a very real sense a single contract. Even then, at least one provision of the ISDA Master Agreement enjoys a particularly robust independent life, being immune even from an attack otherwise fatal to the ISDA Master Agreement itself – that relating to forum selection (I consider the status of the choice of law at [391] below). That reflects the ancillary and independent nature of contractual promises of that kind, and the fact that they are intended to operate in circumstances which will include a dispute by the putative parties as to the validity of their transaction.

362. However, the suggestion that a legal person who does not have capacity to enter into a contract of a particular kind may nonetheless have capacity to promise that it has such capacity, with the result that (to all intents and purposes) it will become subject to the same economic consequences as if it had had the capacity it has been found to lack, is an altogether different proposition. Strictly speaking, the issue of whether Venice had capacity to make such a promise is a matter of Italian law. However, neither party referred me to Italian law evidence on this question, and the legal argument was conducted by reference to English case law and commentary.

363. That case law and commentary provides little support for the Banks' argument:

    i) In an English statutory context, the courts have set their face against any suggestion that a local authority or public body lacking capacity to enter into a particular transaction can nonetheless estop themselves from denying that lack of capacity (the authorities, beginning with *Rhyl UDC v Rhyl Amusements Ltd* [1959] 1 WLR 465 are collected in *School Facility Management Ltd v Governing Body of Christ the King College* [2020] EWHC 118 (Comm), [356]-[358]).

    ii) Given the origins of the two limitations on Venice's capacity which I have found *Cattolica* to establish – the lack of a substantive power to enter into speculative derivative contracts and to have recourse to indebtedness for purposes other than funding investment expenditure – and the important policies of budgetary

equilibrium and the need to protect the integrity of local authority finances in the interests of the public as a whole which those rules give effect to – it would be very surprising if Italian law was any different in this respect. The rationale underlying the English authorities – that bodies of constrained power should not by their own acts be able effectively to enlarge their powers, and thereby undermine the goals which those constraints are intended to achieve – applies with equal force in this context.

iii) In the context of the ISDA Master Agreement, the leading commentaries recognise that the representations as to capacity are unlikely to provide practical legal protection. Dr Alistair Hudson, in *The Law of Financial Derivatives* (6th, 2017), [6-167] suggests that these provisions involve “a clear paradox” because “if the party making the representation that it has capacity to contract does not actually have the capacity to enter into that contract, then the contract will be void ab initio. Therefore, the contract containing the representation (and thus the representation itself) has no effect”. The leading authority on derivative contracts (Professor) Simon Firth, in *Firth on Derivatives*, [11-038], suggests that “little protection is provided by these representations where a breach of them means that the Agreement is invalid because the representations will themselves be unenforceable, along with the other provisions of the Agreement”.

iv) In *Westdeutsche Landesbank Girozentrale v Islington LBC* [1994] 4 All ER 890, 905, Hobhouse J observed of the swaps agreement in that case that “the contract … included the standard warranty of capacity ….; it is recognised by the plaintiffs in this action that it was ultra vires the council to give this warranty just as it was ultra vires the council to enter into the contract as a whole”.

v) The argument was rejected by Tomlinson J (on the basis of expert evidence of Norwegian law but with reference to English law as well) in *Haugesund* [2009] EWHC 2227, [172] (Comm):

> “These arguments must in my view fail on the simple ground pointed out by Professor Graver that "there can be no power under administrative law for public bodies themselves to create new powers by representing that they have such powers". Unsurprisingly Professor Graver's evidence was not challenged. Mr Mitchell distinguishes between a power to enter into a contract and the power to make a statement independently of contract .. However, the answer to Mr Mitchell's point is given by Professor Graver. It was given too by Harman J in *Rhyl UDC v Rhyl Amusements Ltd* … where he pointed out that arguments of this sort which might avail against ‘private people’ cannot prevail as an answer to a claim that something has been done by a statutory body without it having the capacity so to do."

vi) In the specific context of limitations on the capacity of Italian local authorities, in *Regione Piemonte v Dexia Crediop Spa*, [62], Christopher Clarke LJ observed (on an obiter basis) that “if Piedmont did lack capacity to enter into the Transactions, it [sc. the bank] would, of course, be unable to rely on any contractual estoppel since there would be no contract on which to found it”.

vii) In *Busto*, [393]-[408], Cockerill J indicated that she would have rejected a similar argument, for reasons which I consider further in the following paragraphs.

364. The high watermark of the Banks' contractual estoppel case is the decision of Andrew Smith J in *Credit Suisse International v Stitching Vestia Groep* [2014] EWHC 3103 (Comm), which was the subject of detailed consideration by Cockerill J in *Busto*. In that case, there was no dispute that Vestia, a Dutch housing association, had capacity to enter into the ISDA Master Agreement, within the framework of which a series of individual transactions were entered into, some of which were found to be beyond Vestia's capacity. In response, Credit Suisse relied on the standard representations in the ISDA Master Agreement, and on two (bespoke) "Additional Representations":

i) the "compliance representation" to the effect that its entry into and performance of its contractual obligations was and would be in compliance with its articles, financial rules and any other applicable laws or regulations; and

ii) the "hedging representation" – that it was entering into each transaction purely for the purpose of hedging its exposures and not for the purpose of speculation;

which the Judge found (at [300]) took effect as contractual undertakings.

365. The Judge rejected the bank's argument that the standard representations in the ISDA Master Agreement had the effect of estopping Vestia from contending that the transactions were void ([304]-[305]). The bank had acknowledged that the effect of the authorities referred to at [363] above would have been an answer to an estoppel plea so far as a public body such as a local authority is concerned but argued that Vestia was in a different position because it was a private entity. At [305], the Judge held that this made no difference:

> "I do not consider that this assists Credit Suisse, or that Vestia could have extended their contractual capacity by representing (by contract or otherwise) that they have powers which they do not have or that it is within their powers to make a contract when it is not. A contract that is ultra vires the powers of a company is void, and it cannot be validated: see *Chitty on Contr*acts (31st Ed, 2012) vol 1 at paragraphs 9-020 and 9–024, citing the judgment of Russell J in *York Corp v Henry Leetham & Sons* [1924] 1 Ch 557, 573: 'An *ultra vires* agreement cannot become *intra vires* by means of estoppel, lapse of time, ratification, acquiescence, or delay'. Although this was said in the context of the capacity of a local authority, the editors of *Chitty* clearly understand it to be a wider statement of principle, and I agree. The same is said by the editors of *Spencer Bower, The Law relating to Estoppel by Representation*, (4th Ed, 2004) at paragraph VII.6.1: 'nor [can] a company become entitled by estoppel to exceed its statutory powers or those given to it by its memorandum of association' … In my judgment the representations in the Master Agreement and the Management Certificate do not enable Credit Suisse to argue that Vestia are estopped from disputing that the ultra vires contracts were within their capacity or from disputing the authority of Mr de Vries and Mr Staal to make the ultra vires contracts."

366. However, the Judge held that the Additional Representations were in a different position:

> "Would the Additional Representations so interpreted be inconsistent with a policy or principle of law that an entity cannot expand its own capacity by estoppel or contract? In my judgment they would not be. I readily accept that an entity cannot achieve what it has no power to do simply by stating or promising that it has the power, and that underlying the doctrine of ultra vires is a policy of protecting the public: see *Hazell v Hammersmith and Fulham LBC* [1992] 2 AC 1, 36F/G per Lord Templeman. But there seems to me no reason that a legal entity should not in a valid contract 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 in this part of their claim 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."

367. On that basis, he concluded at [321] that "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." That conclusion might be rationalised on the basis that through the Additional Representations which formed part of the ISDA Master Agreement in that case, Vestia had promised that it would not in the future enter into transactions within that framework which did not comply with the Additional Representations, and that it was in breach of that promise. If so, that is not a state of affairs which arises in this case.

368. In *Busto*, [407]-[408], Cockerill J noted a number of distinctions between the position before Andrew Smith J, and the position in that case:

   i) Vestia was a private and not a public entity (with the result that the particular policy considerations which apply to any attempt, in practical terms, to enlarge the scope of the powers of bodies of the latter type are not engaged).

   ii) It was common ground that Vestia had capacity to enter into the ISDA Master Agreement (and indeed the effect of the Judge's findings was that a number of valid swap transactions were entered into within the framework established by that agreement).

   iii) Andrew Smith J found that the standard provisions of the ISDA Master Agreement were not sufficient to reach the conclusion for which the bank was contending in that case, and it was the Additional Representations which proved decisive. In *Busto*, only the former were available.

   iv) The standard ISDA Master Agreement representations relied on are referable to the "Transactions" - which are defined as transactions that the parties have entered into or anticipate entering into. It logically followed that to the extent that the transactions are void for want for capacity they do not fall within the definition of "Transactions".

369. While I would want to reserve my position as to the last argument, and leave open the possibility that a reference to Transactions in that context could extend to purported Transactions (cf *Firth on Derivatives*, [11-038]; while the argument is supported by *Vestia*, [293]), cf [314]-[315]) I agree with the first two. So far as the third is concerned, I do not accept that the "non speculation" representation in this case changes the

position. As I pointed out at [367] above, the ISDA Master Agreement in *Vestia* set a framework for future transactions to be entered into over a period of time, the precise terms and purpose of which had not been fixed in advance, whereas the Venice Master Agreement was entered into at the same time as the Confirmation, and essentially for the purpose of concluding the Confirmation, whose terms and context were known when the representation was made. In such circumstances, I do not accept that a local authority which lacks capacity to enter into speculative derivatives can be estopped from contending that the single transaction in issue was speculative. That amounts, in substance, to a promise that it had the capacity it lacked. In any event, it provides no answer to the absence of capacity resulting from the incurring of indebtedness for purposes other than investment expenditure.

370. For these reasons, *Vestia* does not assist the Banks here, and I am satisfied that the Banks' argument that Venice is estopped from contending that it lacked capacity to enter into the Transactions must fail.

P THE BANKS' OTHER CONSEQUENTIAL CLAIMS

371. In the alternative to their estoppel plea, the Banks advance a series of claims in breach of contract and for misrepresentation which are said to arise if the Transactions are void. Once again, these received limited attention in the course of the trial, but were not abandoned, leaving the court with the task of working through the arguments with only limited assistance from the Banks (and the attendant risks that can involve).

Was Venice in Breach of the Venice Master Agreement?

372. The Banks contend that:

i) If the Transactions are void by reason of non-compliance with Italian legislation, Venice has failed to give notice of an "Incipient Illegality" as defined by Section 14 of the Venice Master Agreement, in breach of Section 4(f) as inserted by paragraph 4(ii) of Part 5 of the Schedule.

ii) If the Transactions are void for any reason, Venice is in breach of the contractual warranties addressed in Section O above.

373. The second of these arguments must fail for the reasons set out in Section O above. As to the first:

i) Section 4(f) provides:

> "**Notice of Incipient Illegality**. If an Incipient Illegality occurs, the Government Entity [defined as Venice] will, promptly on becoming aware of it, notify the other party, specifying the nature of that Incipient Illegality and will also give such other information about that Incipient Illegality as the other party may reasonably require".

ii) An Incipient Illegality is defined as "the enactment of any legislative body with competent jurisdiction over a Government Entity which, once adopted, will render unlawful the performance by such Government Entity of any absolute or contingent obligation to make a payment or delivery or to receive a payment or

delivery in respect of a Transaction or the compliance by such Government Entity with any other material provisions of this Agreement."

iii) I accept Venice's construction that this provision is concerned with legislation which is passed after the ISDA Master Agreement is concluded. That is suggested not only by the fact that the event is described as "the enactment" of legislation, but the clause presupposes the legislation has yet to be adopted – given the words "which once adopted" and the description of the illegality as "incipient". That construction is not only supported by the wording but reflects a practical distinction between legislation which has already been enacted when the ISDA Master Agreement is concluded (which the parties can consider when deciding whether and on what terms to enter into the ISDA Master Agreement) and post-contractual developments. That is a sufficient answer to this point.

iv) In any event, the Banks made no effort to establish that Venice had become aware of any incipient illegality prior to the decision of the Supreme Court in *Cattolica* on 12 May 2020. Nor did the Banks make any attempt to argue that Venice had not given notice of that decision "promptly" or that any failure to do so had caused them any loss. Indeed, it was difficult to discern any causation counterfactual argument in respect of this particular complaint. It therefore takes the Banks nowhere.

Is Venice Liable to the Banks for Damages in Misrepresentation

374. The Banks also advance claims for damages against Venice:

i) under s.2 (presumably s.2(1)) of the Misrepresentation Act 1967; and

ii) in the tort of negligent misstatement;

by reference to various express or implied representations said to be contained in the Venice Master Agreement, the drafts thereof, the Confirmation and Executive Resolution No 3561 of 20 December 2007 (albeit that would only appear to be relevant if the Transactions had been held to be void by reason of non-compliance with Articles 42(2)(i) and/or 192 of TUEL), which it is said were made without reasonable grounds for believing in the truth of the same and/or negligently.

375. These claims had the potential to raise a number of wide-ranging issues:

i) The applicable law.

ii) Whether the representation claims fall foul of the same principles of law which precluded the contractual claims.

iii) What representations had impliedly been made (in particular from the circulation of draft contractual documents), and the proper interpretation of any express representations.

iv) Whether the Misrepresentation Act 1967 applies at all if the Transactions are void.

v) Whether Venice owed the Banks a duty of care.

vi) Whether Venice acted negligently and/or did not have reasonable grounds for believing any of the statement it may be found to have been made which were untrue.

vii) Whether the Banks were induced by Venice's statements as to the truth of those matters into entering into the Transactions (as opposed to a position in which the Banks required Venice to make those statements but was not relying on the fact that Venice had done so as a reason for believing that the statements were true).

viii) If the claim is advanced under s.2(2) of the 1967 Act, whether it is precluded on the basis that rescission is not available.

376. The sum total of the Banks' submissions on these misrepresentation claims is five paragraphs barely stretching over a page, one of which is addressed to the issue of governing law. The argument may have been treated so lightly because it was recognised that the points had no realistic prospect of succeeding if other arguments had failed. If so, the argument should not have been pleaded, or if pleaded, not pursued, not simply left in a wholly undeveloped form for the court to grapple with, with the benefit of Venice's submissions and its own endeavours. In the interests of balance, Venice also ran arguments with no real prospect of success which were not really developed but kept alive with the result that I have had to deal with them. It should by now be clear that this approach is wasteful of judicial time, to the detriment of all court users, and inimical to the efficient conduct of litigation. Legal teams must have the courage to act on their own (almost invariably reliable) assessments of the merits of their own arguments. If an argument is not worth the effort of proper analysis in a written closing, that will almost certainly be because it is not worth advancing at all (although cf [393] and following below).

377. Against that background, I propose to deal with the misrepresentation arguments briefly:

i) In the light of my conclusion that the Transactions were void, the Misrepresentation Act 1967 has no application (*School Facility Management*, [368]). In this case, it is appropriate to treat the Venice Master Agreement and the Confirmation as a single agreement for this purpose (see [361] above). In any event, it was not the entry into the Venice Master Agreement which caused the Banks any loss. Had the parties concluded the ISDA Master Agreement but entered into no confirmations, there would have been nothing for the Banks to hedge. It was the apparent conclusion of the Confirmations which was the cause of the Banks' decision to enter into hedging arrangements (cf *Taberna Europe CDO II plc v Selskabet AF1* [2016] EWCA Civ 1262, [44]-[47]).

ii) On the basis of the law as it was reasonably understood at the time of transacting (including by the Banks and, it is reasonable to infer, Clifford Chance and Beltramo) it was reasonable for Venice to believe that it did have the substantive power to enter into the Transactions, something which it is clear numerous local authorities had done in similar circumstances over the preceding years. The contrary argument ignores the extent to which (as the Banks themselves emphasised in other contexts) the legal position as it emerged from the *Cattolica* decision in May 2020 departed from the reasonable understanding in 2007.

iii) For that reason, also, even if Venice did owe the Banks a duty of care, it did not act negligently.

iv) Any claim under s.2(2) of the Misrepresentation Act 1967 fails because the Banks did not (for obvious reasons) establish (or seek to establish) a right to rescind the Venice Master Agreement (*Salt v Stratstone Specialist Ltd* [2015] EWCA Civ 745) and was not, in any event, seeking damages in lieu of that right.

378. Had it been necessary to go further:

i) I would have had to consider whether my finding that Venice did not have substantive power to enter into the Transactions was also an answer to the misrepresentation or misstatement claim in this case. The contours of the argument on that issue might be influenced by the type and nature of the damages sought, which did not form part of this trial (cf *School Facility Management Limited*, [350]-[364]). In particular, I would have had to consider, in the context of a misstatement-based claim for damages, the implications of the decision on the availability of a defence of change of position in *South Tyneside Metropolitan Borough Council v Svenska International plc* [1995] 1 All ER 545, 565 (to which I return in the context of Venice's restitution claim below) and the view expressed by Tomlinson J in *Haugesund*, [170]-[172] that the lack of contractual capacity in that case was also an answer to the negligent misstatement claim.

ii) I would have had to give careful consideration to the issue of whether the evidence of Mr Binetti and Mr Belarbi, relied on this context, was sufficient to persuade me to conclude that there had been reliance in the relevant sense. In the case of Mr Binetti, his evidence was that he relied on the representations which reflected the parties' common understanding. In the case of Mr Belarbi, it was his evidence that he relied on "Venice's view that it was complying with the law" and that Dexia would not have entered into the Transactions if Venice had refused to make the representations. Against this background, and given (a) the Banks' own expertise in this area; (b) the Banks' greater understanding of the economics of the Transactions and (c) the legal advice available to the Banks from Clifford Chance, it would have been necessary to consider whether the Banks were relying on any representations by Venice as a reason for believing the represented state of affairs was true, or whether the making of such a representation was simply a pre-condition to the contract proceeding from a practical perspective (cf *School Facility Management*, [398]-[401]).

The Banks' Claim Under Article 1338 of the ICC

379. Article 1338 of the ICC provides:

> "Knowledge of causes of invalidity.
>
> The party who, knowing or who should know of the existence of a cause of invalidity of the contract [1418 et seq.], did not inform the other party of this, is required to compensate the damage suffered by this party for having trusted, without its fault, in the validity of the contract [139, 1398]."

380. In the case of public bodies, that is supplemented by a general duty of professional care under Article 1176(2) of the ICC, which has been held to correspond to the public law principle of efficiency under Article 97(2) of the Constitution (Supreme Court Decision No 19833 of 2015). Those provisions do not, however, impose an absolute obligation on Venice, but one of professionalism and due diligence.

381. The short answer to this claim is neither Venice (nor, for that matter, the Banks) "should have known of the invalidity of the Transactions" before the decision of the Supreme Court in *Cattolica* or were at fault in not doing so. Once again, that wholly ignores the extent to which *Cattolica* effected a fundamental restatement of Italian law in the relevant respects. While the Banks point to the fact that Cattolica commenced its proceedings in March 2007, those proceedings failed at first instance, and as late as 2015, Walker J rejected very similar arguments in the *Prato* case, and an appeal against aspects of that decision failed in 2017 (in the agreed exclusive forum for the resolution of claims in relation to the Transactions).

382. I note that my conclusions in this regard accord with those reached by Cockerill J in *Busto*, [422]-[423].

The Banks' Claim under the Indemnity in the Mandate Agreement

383. Article 5 of the Mandate Agreement provides:

> "Indemnification and Release
> The Municipality is obligated, in addition to the legal requirements, release, hold harmless and compensate the Companies and/or every director, executive, employee and shareholder, as well as the member companies of the respective groups that shall be involved in the execution of the assignment described in this agreement, for losses, expenses, costs, damages and liabilities incurred by the same in the performance of this assignment or as a result of the same, within the limits depending on the negligence or fraud of the Municipality or as a direct or indirect result of noncompliance by the Municipality with the provisions of this mandate, and provided that they do not also result from the gross fraud or negligence judicially verified by the Companies."

384. Once again, this claim must fail because Venice did not act negligently in failing to inform the Banks that the Transactions were void.

Q VENICE'S RESTITUTION CLAIMS

385. Venice seeks to recover the amounts it has paid to the Banks under the Transactions. The quantification of that claim is not a matter for this trial, but three issues require determination now:

   i) The applicable law (English or Italian law).

   ii) If the applicable law is English (and not Italian) law, does a defence of change of position arise in relation to the "back-to-back" Hedging Swaps entered into by the Banks?

iii) Whether and to what extent any claims are time-barred (under English or Italian law, as appropriate)?

The Applicable Law of the Unjust Enrichment Claim

386. Under the Rome Convention, which applied at the date of the Transactions:

i) Issues as to the existence of a contract are governed by the law which would apply if the contract had been concluded (Article 8(1)), which in this case would be English law by virtue of the choice of law agreement in the Venice Master Agreement.

ii) Issues as to the consequences of a contract being void are governed by the same law (Article 10(1)(e)).

387. While the United Kingdom adopted the Rome Convention (including the first of those rules), it entered a reservation in respect of Article 10(1)(e) under Article 22 (for reasons which *Dicey, Morris and Collins*, [32-162] do not find "compelling"), with the result that the common law principles of conflicts of law continued to apply to that subject. While there was no similar reservation to Article 12(1)(e) of Rome I which is to the same effect as Article 10(1)(e), Rome I does not apply in this case.

388. Applying the English common law test of "closest and most real connection", Walker J in *Dexia v Comune di Prato* [2016] EWHC 2824 (Comm), [160]-[164] held (on very similar facts to the present case) that the restitutionary claim consequential on the invalidity of the swaps advanced in that case was governed by Italian law, holding that the putative choice of English law to govern the swap if valid was not a sufficient connection with England to outweigh the many connections with Italy. At [164], Walker J stated:

> "Where, however, a restitutionary claim arises because of invalidity of the parties' agreement at the time that it was made, the position seems to me to be inherently different. The mere fact that the agreement identified a governing law is unlikely in these circumstances to give a close or real connection to that governing law. On the contrary, in my view the invalidity of the parties' agreement at the time that it was made will ordinarily have the consequence that the suggested connection is unreal. The position seems to me in principle the same where a restitutionary claim arises because a party has a continuing right to assert the invalidity of the parties' agreement at the time that it was made, and exercises that right. The upshot is that ordinarily a suggestion of a connection with England, if solely based on what was said in the agreement, cannot be made good. The reason is that the party objecting to that suggestion is entitled to say that the suggestion depends upon a link which was invalid from the outset."

389. Cockerill J, on an obiter basis, reached a different conclusion in *Busto* (albeit the case for the application of English law, the choice of law provision apart, was marginally stronger in that case than this because the place of the enrichment was London). At [411], Cockerill J observed:

> "While I would not necessarily place the same weight as did DB on the technical survival of the ISDA Master Agreement, there is force in the submissions that: (i)

that choice of law would retain weight under the *Haugesund* approach of adopting the putative applicable law to determine the civil law consequences of a lack of capacity on the validity of a contract; and (ii) the facts of this case are also distinguishable from Dexia because Dexia was an Italian bank, whereas DB acted through its London branch. The place of enrichment in this case would therefore also be England. Overall, therefore, despite the existence of certain ties to Italy, I would conclude that the closest and most real connection for the putative Transactions was with England."

390. I am satisfied in this case that the unjust enrichment claim has its closest and most real connection with English law by reason of the choice of law clause in the Venice Master Agreement. I have reached that conclusion for the following reasons:

i) Article 8(1) of the Rome Convention recognises that where the issue arises as to the existence of an agreement which, if concluded, would be subject to English law by virtue of a choice of law, English law will be applied in determining whether or not a contract has been concluded. That reflects the importance attached to a putative applicable law, even when there is a dispute as to whether or not a contract was concluded.

ii) On that basis, English law has been applied in this case to issues relating to the Transactions such as the consequences of Venice's lack of capacity and whether the lack of actual authority on Mr Dei Rossi's part is sufficient to render the Transactions void.

iii) Those matters are sufficient to show that, even when the validity of the contract is in dispute, or it has been determined that the contract is void, the parties' putative choice of English law is still legally significant.

iv) Further, there is, at least, a logical connection between the system of law which decides that a contract is void (English law in this case), and the law to be applied in determining what the consequences of it being void are on the parties to the extent they had purported to perform it. I note that in *Arab Bank Ltd v Barclays Bank (Dominions, Colonial and Overseas)* [1953] 2 QB 527, 572, Jenkins LJ observed:

> "An interesting argument was presented to us as to the local situation of the resuscitated claim, supposing such a claim to exist. As to that, I need only say that the claim as formulated by Sir Andrew was by definition situated outside Israel; but that if the cancellation of the contractual debt was brought about by Israeli law, it would at least be logical also to look to Israeli law for the consequences of such cancellation, and to regard any substituted obligation as the creature of that law, and consequently as situated in the country to whose law it owed its existence. It is, however, unnecessary in the view I take to give any decided answer to this hypothetical question, and I refrain from doing so."

v) While the issue does not appear to have been raised directly in *Haugesund*, Aikens LJ appears to have assumed that English law governed the restitutionary claim in respect of a void contract which would have been governed by English law, and addressed the significance of the foreign statute to such a claim not on the basis

that the case was being argued by reference to English law only as a matter of convenience but on the basis that English law was indeed applicable (see [97]-[100]).

vi) Finally, the payments in question were made by Venice on the understanding that they were required by English law obligations, in discharge of English law debts, with the Banks having the same understanding in receiving them. The fact that the payments were made and received on the basis of *assumed* English law obligations is, to my mind, highly significant, it being the natural expectation in those circumstances that English law would apply to issues relating to security of receipt and rights of recovery.

391. This analysis has necessarily been conducted on the basis that the choice of law in the ISDA Master Agreement is only putative (that is to say that it is a choice which only has contractual force if the ISDA Master Agreement is valid). As I have noted at [361] above, there are some contractual provisions – in particular choice of forum provisions – which are ancillary or collateral in nature, and are intended to be severable from the framework agreement to which they are attached.

392. The choice of law provision in the ISDA Master Agreement is fairly narrowly expressed, the Agreement being "governed by and construed in accordance with" English law (Section 13(a) and Schedule Part 4(h)). However, there is scope for debate as to whether an agreement of this type (or one expressed in broader terms) could take effect as an ancillary agreement that English law would apply to claims arising from the purported entry into the contract even if it was void for lack of capacity, as well as those premised on the contract having been originally binding, on the basis that clauses of this kind are also intended by the parties to be capable of operating in circumstances in which the existence of the substantive contract is in dispute.

Do the Banks Have a Change of Position Defence?

393. It is common ground that no change of position defence arises as a matter of Italian law. It is accepted that English law recognises such a defence, but its availability on the facts of this case is in dispute. At this point, the judgment must venture into the treacherous terrain encountered when a dispute as to the law of unjust enrichment arises in what, in the context of the case as a whole, has been treated as a subsidiary and short point: because judgments on points of this kind are almost invariably subject to more detailed analysis *ex post* than the issues themselves received *ex ante* in the course of argument.

394. I can begin with the common ground that money paid by one party under a void contract, such as a payment made under a void swap, is in principle recoverable in unjust enrichment. The claim for restitution in these circumstances is sometimes explained on the basis that the payment was made on the basis of a condition – namely the condition of the payor having a legal right to counter-performance under the contract, and perhaps also of the counter-performance itself. Dealing with an ultra vires contract in a non-swaps context, I summarised the position as follows in *School Facility Management*, [421]:

> "It is clear from the treatment of unjust enrichment claims in respect of payments made under wholly executed ultra vires swaps that the mere fact that the anticipated counter-performance has been received does not preclude a claim in

unjust enrichment by the net payer based on the mistake as to the existence of the contract (*Guinness Mahon & Co Ltd v Kensington and Chelsea Royal London Borough Council* [1999] QB 215). This case can be seen as treating payments under void swap contracts as conditional in two respects: conditional on the receipt of counter-performance, but conditional also on the conclusion of a binding contract and the legal rights which would follow from that. I can see no objection in principle to the transfer of a benefit being subject to more than one condition, failure of any one of which will generate a claim in unjust enrichment. This analysis is supported by the editors of *Goff and Jones* (paras 13.14–13.15) and also by the Singapore Court of Appeal in *Benzline Auto Pte Ltd v Supercars Lorinser Pte Ltd* [2018] 1 SLR 239, para 52 in which Judith Prakash JA observed: '[Although] it is usual and convenient to refer to the basis of a transfer, the reality is that, as the learned authors of *Goff & Jones* observe at para 13-14, a transfer may have more than one basis.'"

395. In that case, I held that it was open to the defendant to the unjust enrichment claim to raise a change of position defence, albeit of a particular kind. That raises the first important point of principle in this case. The decision in *School Facility Management* has been criticised in this respect, it being said that where restitution is sought on the basis that one of the conditions for conferring the benefit has not been satisfied, there can be no legitimate change of position on the recipient's part. For example, Mr Alex Georgiou in "What's 'Unjust' About Unjust Enrichment: An Answer at Last?" [2020] LMCLQ 63, 71 observed of the first instance decision:

> "The decision in *SFM* still leaves some difficult questions. For instance, Foxton J accepted that a defence of change of position lies in response to a claim based on failure of an (express) condition; however, this position has been robustly criticised for rewriting the bargain between the parties. Unfortunately, Foxton J's judgment had little to say about these concerns. Some resolution of this issue may be called for, particularly if there is merit in a generalised condition-based model (as is some consideration of the differences, if any, between express and implied conditions for the purposes of change of position)."

396. To similar effect, when commenting on the Court of Appeal decision in that case ([2021] EWCA Civ 1053), Mr Timothy Pilkington and Dr David Winter in "Void Contracts, Counter-restitution and Change of Position" (2022) 138 LQR 21, 26 observed:

> "As to whether the availability of a change of position defence should prevent engagement of the counter-restitution principle, according to the preceding analysis, this depends principally upon whether this defence applies to unjust enrichment claims premised upon a failure of condition. If the reason for restitution for failure of condition is the parties' agreement that the claimant's conferral of the relevant benefit was conditional, it is doubtful that a change of position defence should be available. To deny restitution for a failure of condition because the defendant changed its position would be inconsistent with this agreement: see Stevens (2018) 134 L.Q.R. 574 at 587. This also suggests that Foxton J.'s decision at first instance, that SFM had a change of position defence to the college's restitutionary claim for hire payments already made, was incorrect because the basis for the college's claim for restitution of these payments was failure of condition."

397. The basis for permitting a change of position defence in *School Facility Management* was narrow, and to a degree pragmatic. As I noted at [467]:

> "The College did not seek to argue that a defence of change of position was not open to SFM to the extent that its claim in unjust enrichment was premised on a failure of basis, no doubt recognising that the nature of the change of position relied upon in this case was expenditure directly incurred in preparation for the Contract (see the discussion in *Goff and Jones*, at paras 27-58 to 27-60)."

Those passages in *Goff and Jones* (9th) provide:

> "When money is paid to a recipient on an agreed basis, he knows that he may have to repay a like sum if the basis fails to materialise, suggesting that he cannot spend the money in the honest belief that the transferor had an unqualified intention to benefit him. So, for example, if a claimant pays a defendant money to build a house, and the defendant spends it on a holiday that he would not otherwise have bought, the law will almost certainly not permit him to rely on this fact in the event that the house is not built and the claimant sues to recover his money.
> 27-59
>
> *Goss v Chilcott* was like this. The defendants borrowed money from the claimant under a void agreement, which was paid to a third party at the defendants' request. This arrangement did not constitute a change of position because the defendants knew that if the third party failed to repay the money then the claimant would require the defendants to repay it themselves. This decision was affirmed and followed by the Court of Appeal in *Haugesund Kommune v Depfa ACS Bank*, where the defendant local authorities could not raise the defence in response to claims by a bank from which they had received money under void interest swap agreements, and which they had used to invest in financial instruments that declined in value.
>
> An exception to this principle is that payments to meet preparatory expenses will constitute expenditure on which a defendant can rely: in *BP Exploration Co (Libya) Ltd v Hunt (No 2)* Robert Goff J held that the statutory allowance for such expenses given by the Law Reform (Frustrated Contracts) Act 1943, s.1(2), should be seen as a statutory example of the change of position defence. However, a defendant cannot invoke the defence if he spends money on materials which will not actually help him to perform his agreement. These were the facts of a New Zealand case, *Saba Yachts Ltd v Fish Pacific Ltd*, where the defendant commissioned plans for a boat that fell outside the specification of the boat which it had agreed to build for the claimant."

398. However, the facts of this case raise the concerns expressed in these commentaries in more acute form, because the expenditure relied upon by the Banks in support of their change of position defence relates to the payments made under the "back-to-back" Hedging Swaps. I am conscious that the issues this topic engages have been the subject of a significant body of critical commentary, but it would not be feasible to seek to address that material when producing this judgment. What follows is, necessarily, an attempt to arrive at the answer through first principles.

399. When dealing with a legal principle which we were told at its birth was best developed on a "case by case" basis (*Lipkin Gorman v Karpnale Limited* [1991] 2 AC 548, 558, and 580 per Lords Bridge and Goff), it may be helpful to stake out some fixed positions as points of reference:

i) It is generally accepted that where the recipient acquires the benefit on what appears to be an unconditional basis (for example a mistaken payment into the recipient's bank account to which the recipient believes they are entitled), which causes the recipient to spend money it would not otherwise have spent, a defence of change of position will apply (ignoring any complications arising from surviving value). The example of the "innocent" recipient of a mistaken payment who, as a result, makes a gift to charity given by Lord Templeman in *Lipkin Gorman*, p.579 falls into this category.

ii) Equally, where the benefit is acquired on a basis whereby it is to be repaid (e.g., money paid to the "borrower" under a void loan), it will be no answer to a claim for restitution that the recipient has spent the money. This was the position in *Haugesund*, in which the local authority had engaged in *ultra vires* swaps transactions, used the upfront receipt to make investments which had failed, and then sought to rely on those failed investments as giving rise to a change of position defence to the counterparty's claim for restitution. As, on its own understanding of the transaction it thought it had entered into, the local authority was always going to have pay the amount received back with interest, whether the investments succeeded or failed (such that the payments were economically "conditional", even on the transaction as it was believed to be), there was no good reason to afford the local authority a change of position defence: [124]-[126].

iii) When money is paid to a recipient subject to a condition which the recipient knows has yet to be satisfied, and the recipient spends the money for their own purposes, the defence of change of position will not be available: e.g. the example in *Goff and Jones,* [27-58] of the builder who receives an upfront payment for building works who knows the payment is conditional on the work being done, spends the money on a holiday, and it then proves impossible for the work to be done (without the fault of either party). To similar effect see Professor Robert Stevens, "The Unjust Enrichment Disaster" (2018) 134 LQR 574, 587.

iv) As noted at [397] above, there is support for the view that the outcome in the preceding example may be different if the sums received are expended for the purpose of the contract to be performed (although it may be possible to analyse these cases on the basis that the purpose of the "advance" payment was in part to put the recipient "in funds" to meet that preparatory expenditure).

400. The present case raises a rather different problem – the parties shared a common understanding that they owed each other binding obligations, on the faith of which one of them changed its position, and then faced an unjust enrichment claim from the other when the true position became apparent (per *Guinness*, because one of the conditions of its own payments had not been satisfied, namely a legal enforceable right to counter-performance). The idea that the defence of change of position can never be available in a void contract case is not attractive. It pays little regard to the importance of protecting security of receipt and those who have conducted themselves on the basis of appearances which underlie the defence of change of position (Lord Goff in *Kleinwort*

Benson Ltd v Lincoln CC [1992] 2 AC 349, 382). These have been long-standing concerns of English commercial law, and before that the law merchant (and are manifest in, for example, the doctrine of ostensible authority, the ability of the buyer in possession to pass good title, the principle of market overt, and the traditional resistance of English commercial law to arguments based on constructive notice). The circumstances in which the parties were operating in this case bear some similarities to the first category in [399(i)] above, save that it might be said that the position is even stronger because *both* the payer and the recipient were acting on the basis of an apparent state of affairs that the condition for Venice's payments (the existence of legally enforceable rights to counter-payments) had been satisfied. It is noteworthy that many commentators explain the unavailability of the defence of change of position in failure of condition cases by reference to the position where the recipient *knows* that the condition has not been satisfied (for example Professor Robert Chambers, "Proprietary Restitution and Change of Position" and Professor Elise Bant, "Change of Position: Outstanding Issues", both in Andrew Dyson, James Goudkamp and Frederick Wilmot-Smith, *Defences in Unjust Enrichment* (2018) at 119 and 134 respectively).

401. Further, the nature of the change of position contended for by the Banks was not engaging in expenditure wholly unrelated to the obligations arising under the Transactions (sc. the builder who spends the advance payment on a holiday) but entering into and performing contracts entered into for the purpose of hedging their liabilities under the Transactions. I accept that, in this sense, the hedges were not capable of being of any benefit to Venice independently of the fact that their ability to hedge made it more likely that the Banks would enter into the Transactions. However, as noted at [339]-[341], it is routine and objectively foreseeable that banks entering into transactions of this type will hedge them. Reverting to the example in [399(iv)] above, if the builder had used the advance payment not to buy concrete or bricks, but to purchase contractors' all risks insurance for the project even though this was not required under the construction contract or to make a payment by way of a retainer to ensure that a particular sub-contractor would be available during the construction period, I am not persuaded that the legal analysis would be any different.

402. On this basis, I am satisfied (certainly in the particular circumstances of this case) that a defence of change of position is, in principle, available notwithstanding the fact that Venice's right to restitution arises from the fact that a condition of those payments (a legally enforceable right to the counter-payments) was not satisfied.

403. That leads to the second objection to allowing the Banks to raise a defence of change of position on the basis of the "back-to-back" Hedging Swaps they have entered into – that the relevant change of position (entry into the swaps) occurred before receipt of the payments of which Venice seeks restitution, and that the payments made under the back-to-back Hedging Swaps were made because of the legal liability to do so arising under those swaps.

404. There are two first instance authorities which have held that those objections are fatal to any attempt by a bank to rely on its liabilities under a hedging swap as giving rise to a defence of change of position to a claim by its original swap counterparty to recover payments made under a void swap:

i) *Westdeutsche Landesbank Girozentrale v Islington LBC* [1994] 4 All ER 890, 948-949 where Hobhouse J held that:

> "There has been no alteration of the position of Westdeutsche since it received the sums paid to it by Islington. The change of position occurred … when [the bank] entered into [the hedging contract] … The contract was, as a legal transaction, wholly independent of Westdeutsche's transaction with Islington. The supposed existence of the contract between Westdeutsche and Islington has provided the motive for Westdeutsche to enter into a contract with Morgan Grenfell, but that was all. Therefore, there has been no change of position of Westdeutsche relevant to any claim which Islington might have had against it. Thirdly, whilst it is presently correct that Westdeutsche as the floating rate payer under its contract with Morgan Grenfell is presently out of pocket, it does not follow that this will be the final outcome of that contract. While high interest rates have prevailed on the sterling market on London, the contract has been disadvantageous to the floating rate payer. If the situation becomes one where low interest rates prevail then the contract will become advantageous to the floating rate payer; Westdeutsche will start to be in a position where it receives payments rather than has to make them and it is perfectly possible this may fairly quickly extinguish and reverse the loss of £3 m. To assert that Westdeutsche will have made a loss through entering into the Morgan Grenfell contract is simply a speculation".

ii) *South Tyneside MBC v Svenska International plc* [1995] 1 All ER 545, 565, where (after referring to Hobhouse J's decision) Clarke J held:

> "In my judgment in circumstances such as these the bank is not entitled to rely upon the underlying validity of the transaction either in support of a plea of estoppel or in support of a defence of change of position. That is because the transaction is ultra vires and void. It is for that reason that in a case of this kind, save perhaps in exceptional circumstances, the defence of change of position is in principle confined to changes which take place after receipt of the money. Otherwise, the bank would in effect be relying upon the supposed validity of a void transaction".

405. It is possible to identify a number of threads running through these judgments:

i) First, that the banks had committed themselves to the terms of the hedging swap in advance of the receipt.

ii) Second, that in those circumstances it follows that banks would be founding the defence on the basis of the apparent validity of a void transaction with a public authority.

iii) Third, that the banks' decisions to enter into the hedging swaps was a wholly independent decision taken for their own purposes.

iv) Fourth, the fact that it was not known whether or not the entry into the hedging transactions would, or would not, ultimately prove to be economically disadvantageous for the banks.

406. So far as the first of those threads is concerned, the law has moved on considerably since the decisions in *Westdeutsche* and *South Tyneside*. It is now clear from the

decisions of the Privy Council in *Dextra Bank and Trust Co Ltd v Bank of Jamaica* [2002] 1 All ER 193 and the Court of Appeal in *Jones v Commerzbank AG* [2003] EWCA Civ 1663, ([38] and [47]) that the defence of change of position can be established by action taken before, but in anticipation of, the receipt of the amounts of which repayment is sought. In *Dextra*, [38], the Privy Council observed:

> "It is true that, in the second case, the defendant relied on the payment being made to him in the future (as well as relying on such payment, when made, being a valid payment); but, provided that his change of position was in good faith, it should provide, pro tanto at least, a good defence because it would be inequitable to require the defendant to make restitution, or to make restitution in full."

407. The Privy Council considered Clarke J's decision in *Svenska* at [39], observing:

> "It follows that the exclusion of anticipatory reliance in that case depended on the exceptional facts of the case; though it is right to record that the decision of Clarke J has been the subject of criticism—see, eg, Goff and Jones, *Law of Restitution* … pp 823–824."

408. So far as the second objection is concerned, in *School Facility Management*, the College argued that it was this feature – the attempt to found a defence of change of position on the basis of payments made in reliance on the validity of a void contract with *a public authority* – to which Lord Goff was referring in *Dextra* when referring to the "exceptional" facts of the *Svenska* case. I rejected that argument (at [473]-[478]), noting that Cranston J had allowed a defence of anticipatory change of position to be advanced in response to a claim to recover payments made under an ultra vires contract by a public authority in *Charles Terence Estates Ltd v Cornwall Council* [2012] PTSR 790, [98]. I concluded at [478] that "there is no principled basis for the distinction which the College invites me to draw in its submissions between anticipatory and consequential change of position in public authority cases." Before me, Venice did not dispute that general proposition.

409. It was the third objection on which Venice laid particular emphasis, noting that *Goff and Jones*, [27-36] footnote 101 suggests that *South Tyneside* can be analysed as a case in which the "back to back" hedging contract was too remote (and see also [27-33]). In this regard, I am not persuaded that it matters that it is the legal commitment to make the payments relied on as constituting a change of position, rather than the actual payments themselves, which were made in anticipation of the future receipt of payments from the party now seeking restitution of them. If in *Dextra*, the receiving bank had undertaken an irrevocable commitment to credit their authorised agents at a fixed date after the date of payment in anticipation of the receipt of the cheque, rather than crediting their accounts in advance, it is difficult to see how it would have made a difference to the availability of a change of position defence. In my view, that would also be the case if in *Charles Terence Estates* the payee had assumed irrevocable legal obligations to pay for the refurbishment of the properties rather than having completed the work. In many anticipatory reliance cases, there will be a point in time in which the future recipient has committed itself in law to make the payment in anticipation of the future receipt but has yet to perform the assumed obligation.

410. If so, then the suggestion that the "back-to-back" Hedging Swaps are "wholly independent" or "too remote" must be premised on the fact that the Banks were not

required to take out the hedges either as a term of the Transactions or in order to perform their obligations under the Transactions (which they were not). Venice put its case as follows:

> "The question of whether the Banks would ever receive any payments from Venice at the time of entry into the swaps was indeterminate: the market could have changed, and Venice could have been a net payee throughout. In that context, it cannot be said that the Banks were relying on receipt of any payment by Venice when entering into the back-to-back hedges; on the contrary, they were seeking to hedge the risk that they themselves might need to make payments".

411. That is no negligible submission. The purpose of a hedge is, as a matter of commercial reality, to protect the recipient against the risk of having to make payments *to* the original counterparty (the price of protection against that risk being the liability to make payments broadly equivalent to those *received* from the original counterparty). However, the decision to incur the obligation (in certain market conditions) to make payments under the hedge was undoubtedly taken in anticipation of the fact that, in those same market conditions, the bank would receive a largely equivalent payment from its counterparty under the impugned swap. While the payment would be conditional in both cases on prevailing market conditions, in my view it remains the case (adopting the language of the Privy Council in *Dextra*, [38]) that "it is surely no abuse of language to say, in the second case as in the first, that the defendant has incurred the expenditure [sc. the obligation to pay the expenditure] in reliance on the plaintiff's payment".

412. In *A Restatement of the English Law of Unjust Enrichment* (2012), 117, Lord Burrows distilled the law on change of position into the following summary:

> "(1) The defendant has a defence to the extent that—
>
> (a) the defendant's position has changed as a consequence of, or in anticipatory reliance on, obtaining the benefit, and
>
> (b) the change is such that the defendant would be worse off by making restitution than if the defendant had not obtained, or relied in anticipation on obtaining, the benefit.
>
> (2) But the defendant does not have this defence if—
>
> (a) the change of position—
>
> (i) was made in bad faith, or
>
> (ii) involved significant criminal illegality, or
>
> (iii) constituted the taking a risk with loaned money, or
>
> (b) the weight to be attached to the unjust factor is greater than that to be attached to the change of position (as, for example, where the unjust factor is the unlawful obtaining of a benefit by a public authority".

413. I can find nothing in that summary which would deny the Banks a change of position case where they had entered into back-to-back transactions by which they assumed (conditional) payment obligations in anticipatory reliance of receiving essentially the same payments from Venice. Indeed, the routine and objectively foreseeable nature of that anticipatory reliance, and its "back-to-back" nature (with the Banks' anticipatory reliance essentially mirroring the anticipated receipts) would seem to make this a paradigm case for the availability of the defence of change of position.

414. That leaves Hobhouse J's final point – that it is not known at this point in time whether or not the Hedging Swaps will or will not involve ultimate net payments by or to the Banks. This is not an argument as to the availability of the defence of change of position in principle, but an argument that the recipient is unable to establish that they are worse off because the final outcome of the hedging transaction is not yet known. However, as at the date restitution is sought and/or ordered, the Banks will have made net payments under the hedging transactions which can be quantified (just as Venice has made net payments under the Transactions, in its case of €71,995,659.95). Further, the current MTM and cost of winding-up the Hedging Swaps will be known, just they are known for the Transactions (the Banks' submissions suggest that the MTM on the Transactions is currently -€20,967,401, a significant improvement on earlier valuations due to recent movements in interest rates and forward interest rate expectations).

415. The issue of whether a change of position defence is precluded in these circumstances raises three issues in the law of unjust enrichment.

416. The first is whether the defence of change of position is limited to cases in which a reduction in the recipient's assets in a particular amount can be established, or whether it can apply when something inherently more uncertain in quantitative terms is made out. In *Scottish Equitable plc v Derby* [2001] 3 All ER 818, [32], Walker LJ appeared to contemplate a wide variety of matters being capable of constituting change of position, not all of which would be susceptible to precise monetary quantification:

> "When a person receives a mistaken overpayment there are, even on the narrow view as to the scope of the defence, a variety of conscious decisions which may be made by the recipient in reliance on the overpayment. Some are simply decisions about expenditure of the receipt: the payee may decide to spend it on an asset which maintains its value, or on luxury goods with little second-hand value, or on a world cruise. He may use it to pay off debts. He may give it away. Or he may make some decision which involves no immediate expenditure, but is nevertheless causally linked to the receipt. Voluntarily giving up his job, at an age when it would not be easy to get new employment, is the most obvious example. Entering into a long term financial commitment (such as taking a flat at a high rent on a ten-year lease which would not be easy to dispose of) would be another example. The wide view adds further possibilities which do not depend on deliberate choices by the recipient."

417. In *Kinlan v Crimmin* [2006] EWHC 279 (Ch), [60], a change of position defence succeeded on the basis that:

> "even though he may still in fact have in his hands the monies paid to him or assets representing those monies (this point was not explored at trial), Mr Crimmin changed his position in a fundamental respect in good faith in reliance

on his assumption (shared with Mr Smith and the company) that the agreement was valid and that the sums he received under it were validly paid to him. Had he realised that the agreement was invalid and the payments made under it were made by mistake, Mr Crimmin would obviously have wished to consider how his continuing interest in the company should be protected, either by his resuming his rights to protect himself as a quasi-partner in the business or by seeking the reformulation of the agreement so as to ensure that it and the payments to him were valid. These opportunities which were denied him cannot be restored to him. In my judgment, in these unusual circumstances, this was a change of position on the part of Mr Crimmin such as to fall within the scope of the defence of good faith change of position articulated by the House of Lords in *Lipkin Gorman*. Accordingly, whilst I hold that cl. B1 and associated provisions of the agreement were in fact void, I also hold that Mr Crimmin has a good defence to the claim for repayment of monies which is now made against him."

418. Finally, in the High Court of Australia in *Australian Financial Services and Leasing Pty v Hills Industries Limited* [2014] HCA 14, a defence of change of position succeeded because the payment had caused the recipient not to pursue alternative legal rights of uncertain outcome and to continue trading with a particular customer. French CJ at [23] approved Professor Elise Bant's statement in *The Change of Position Defence* (2009), 134 that "there may be changes of position which are difficult or even impossible to value which are not, on that account, irrelevant for the purpose of the defence." At [26], he rejected the argument "that where the change of position relied upon by the recipient of a mistaken payment is a form of economic loss, including loss of an opportunity, the defence operates only to the extent of that value, which the court should determine as best it can". The combined judgment of Hayne, Crennan, Kiefel, Bell and Keane JJ was to similar effect.

419. On the basis of these authorities, I am satisfied that mere difficulty in ascertaining the extent of any change of position is not in itself an answer to an asserted change of position defence. Indeed, it is striking that in the latter two cases, the effect of the uncertainty was that the defence succeeded in full. In the *Australian Financial Services* case, French CJ observed at [1] that:

> "Change of position may apply as a pro tanto defence where the detriment can readily be quantified. This is not such a case. Contrary to the submissions of the appellant, change of position applies in this case as a complete defence to the appellant's claim."

420. Second, at what date does the court assess whether or not there has been a change of position? There is a body of authority which suggests that the position is to be determined at the date of the demand for repayment:

i) In the *Scottish Equitable* case, [45]-[47], Walker LJ observed:

> "[45] I should record one further novel and ingenious argument addressed to us by Mr Moriarty (but generously attributed by him to his junior, Mr Handyside). That is that, since *Lipkin Gorman* , the defence of change of position pre-empts and disables the defence of estoppel by negativing detriment. Detriment must, it was correctly submitted, be

judged at the time when the representor seeks to go back on his representation, since

> '… the real detriment or harm from which the law seeks to give protection is that which would flow from the change of position if the assumption were deserted that led to it. So long as the assumption is adhered to, the party who altered his situation upon the faith of it cannot complain. His complaint is that when afterwards the other party makes a different state of affairs the basis of an assertion of right against him then, if it is allowed, his own original change of position will operate as a detriment.'

(Dixon J in *Grundt v Great Boulder Pty Gold Mines* (1938) 59 CLR 641 , 674–5, quoted in Spencer Bower and Turner, *The Law Relating to Estoppel by Representation* 3rd ed (1977) pp.110–1).

[46]. The argument can be simply explained by an illustration in the form of a dialogue. A pays £1000 to B, representing to him "I have carefully checked all the figures and this is all yours". B spends £250 on a party and puts £750 in the bank. A discovers that he has made a mistake and owed B nothing. He learns that B has spent £250 and he asks B to repay £750.

B: "You are estopped by your representation on which I have acted to my detriment."

A: "You have not acted to your detriment. You have had a good party, and at my expense, because I cannot recover the £250 back from you."

The facts that B has spent £250 in an enjoyable way, and that A readily limits his claim to £750, put the argument in its most attractive form. But it seems to have some validity even if B had lost £250 on a bad investment, and A began by suing him for £1000.

[47]. I find this argument not only ingenious but also convincing. If I prefer to base my conclusion primarily on the grounds relied on by the judge it is partly because the argument is novel and appears not to have been considered by any of the distinguished commentators interested in this area of the law. But at present I do not see how the argument could be refuted."

ii) That approach was commented upon with apparent approval by Clarke LJ in *National Westminster Bank plc v Somer International (UK) Limited* [2001] EWCA Civ 970, [61]:

"I am not sure that this approach is markedly different from that described by Robert Walker LJ in paragraphs 45 to 47 of his judgment in *Scottish Equitable* and referred to as a 'novel and ingenious point'. If, as Dixon J put it in *Grundt v Great Boulder Gold Mines* (1938) 59 CLR at pages 674-

5, and as Robert Walker LJ said was correct in paragraph 45, detriment must be judged when the representee seeks to go back on his representation, the recipient will not have acted to his detriment if he is entitled to keep the part of the money that he has spent but not the rest. Provided that he is entitled to keep the amount spent, it is likely (subject to the circumstances of the particular case) to be unconscionable to allow him to keep the rest, in which event he should not in principle be entitled to do so. As I see it, the application of what may be called the unconscionability test does not involve the exercise of a discretion but provides a principled approach to the problem in a case of this kind."

iii) The approach was also approved by French CJ in the High Court of Australia in the *Australian Financial Services* case, [23] when he observed that "the requirement that detriment be assessed at the time of demand for repayment is justified by reference to the analogous requirement in estoppel explained by Dixon J in *Grundt v Great Boulder Pty Gold Mines Ltd***."**

421. Adopting that approach to the date of determination of the recipient's change of position, the concerns raised by Hobhouse J in *Westdeutsche* as to how the value of the hedging transaction might change over the remainder of its life would not seem to arise.

422. The third, and related, issue is that of "surviving value". When the recipient changes their position by purchasing an asset which they would not otherwise have purchased, the defence of change of position is generally disallowed to the extent of the surviving value of that asset. In *Lipkin Gorman*, p.560, Lord Templeman gave the example of a recipient of a payment who buys a car they would not otherwise have bought, who he suggested suffered no greater detriment than the decline in value of the car between the date of purchase and the date of the proceedings. In *Credit Suisse (Monaco) SA v Attar* [2004] EWHC 374 (Comm), [98], Gross J rejected a defence of change of position in respect of funds used to purchase shares which had appreciated in value and been sold. While in the latter case the value of the asset acquired in the "change of position" transaction had been realised, I am satisfied that the "surviving value" of such an asset which had not been sold would still be brought into account when establishing the extent of any change of position (subject to such complications as might arise from any difficulties in realising the value of the asset: see *Goff and Jones*, [27-18 to 27-20]).

423. The fact that the value of the asset might subsequently increase over time does not seem a sufficient reason for refusing a defence of change of position altogether, any more than (with regard to the "surviving value" of a ready realisable asset) the fact that its value might fall. The position is analogous to contractual damages claims where a claimant chooses not to enter the market but to await events, of which Robert Goff J observed in *Koch Maritime Inc v D'Amica Società di Navigatione (The Elena d'Amico* [1980] 1 Lloyd's Rep 75, 89:

> "Now where, as for example in a case of a breach by a seller in failing to deliver the goods on the due date, there is an available market and advantage is not taken of the available market then, generally speaking, the decision by the buyer not to take advantage of the available market is an independent decision, independent of the breach, made by the buyer on his assessment of the market. It is perfectly true that his decision is made in the context of a pre-existing breach of contract by the seller, in the sense that the breach of contract provided the occasion upon

which the buyer makes his market judgment; but even if there had been no breach at all it would have still been possible for the buyer to have made the same decision. For example, if the goods had been delivered on the due date he could, if he had so wished, have sold the goods on the date of delivery and then have bought in comparable goods at a later date. The position was made clear by Lord Wrenbury when he delivered the advice of the Privy Council in the case of *Jamal v. Moolla Dawood Sons & Co.*, [1916] 1 A.C. 175. That was a case concerned with a contract for the sale of shares and not with a contract for sale of goods, and the breach was a breach by the buyer and not by the seller. But in that context Lord Wrenbury said (at p. 179):

> '. . . If the seller retains the shares after the breach, the speculation as to the way the market will subsequently go is the speculation of the seller, not of the buyer; the seller cannot recover from the buyer loss below the market price at the date of the breach if the market falls, nor is he liable to the purchaser for the profit if the market rises.'

So, in that situation, generally speaking, the decision not to take advantage of the available market is the independent decision of the innocent party, independent of the wrongdoing which has taken place. It takes place in the context of a pre-existing wrong but it does not, to use Viscount Haldane's expression, 'arise out of the transaction'."

424. Pulling these strands together, I am satisfied that there is a principled case for recognising a defence of change of position to the extent of any swap payments made by the Banks under the Hedging Swaps, subject to two points:

i) issues of quantification which did not form part of this trial; and

ii) the issue of whether any different treatment attaches to those payments made after Venice sent its letters of 10 December 2020 stating that any payments were being made without prejudice to its contentions that the swaps were void (which might be thought to raise the issue discussed at [395] to [396] above particularly acutely).

425. However, a decision to that effect would involve me not following the result in *Westdeutsche* and *South Tyneside* addressing essentially the same issue, and aspects of the reasoning in those cases. I have considered whether I should follow those decisions, and leave it to the inevitable appeal to determine whether the analysis I have arrived at is correct (cf [165(i)]). However, the reasoning in the two cases is not the same and aspects of it cannot survive developments in the law of unjust enrichment over the subsequent 25 years. I also note that, on an obiter basis, Cockerill J in *Busto* indicated that in the light of subsequent case law and commentary, she would not have followed those judgments if the issue had arisen ([415]). In these circumstances, I have decided that I should act on the understanding of the law which I have arrived at, and allow the Banks' change of defence in principle. The outcome which that entails tempers at least some of the consequences which would otherwise flow from a legal development in 2020 leading to a transaction which both parties had treated as binding for nearly 13 years being held to be void from the outset.

Is Venice's Claim for Restitution Time-Barred?

426. There is no dispute that each payment made by Venice gives rise to a separate cause of action (*Goff and Jones*, [33-11]). In respect of those payments made more than 6 years before the issue of the Claim Form (this being the relevant date rather than the date of Venice's counterclaim: s.35(1)(b) and (3) of the Limitation Act 1980 and *Al-Rawas v Hassan Khan & Co* [2017] EWCA Civ 42, there being no suggestion in this case that the counterclaim was not brought in time). Proceedings were issued on 15 August 2019, with the result that, prima facie, payments made prior to 16 August 2013 are not recoverable.

427. Venice relies on s.32(1)(c) of the Limitation Act 1980 which provides:

> "(1) … where in the case of any action for which a period of limitation is prescribed by this Act, … —
>
> (c) the action is for relief from the consequences of a mistake;
>
> the period of limitation shall not begin to run until the plaintiff has discovered the … mistake … or could with reasonable diligence have discovered it. References in this subsection to the defendant include references to the defendant's agent and to any person through whom the defendant claims and his agent."

428. It contends that it made the payments under the mistaken belief that the Transactions were valid and binding, and that it could not with reasonable diligence have discovered its mistake until the decision of the Supreme Court in *Cattolica*.

429. It is clear as a matter of English law that local authorities who paid amounts believed to be due under swap contracts could rely on s.32(1)(c) when seeking to recover those payments, on the basis that their belief involved a mistake in the light of the subsequent decision in *Hazell v Hammersmith and Fulham LBC* [1992] 2 AC 1 that such swap contracts were void: *Kleinwort Benson Limited v Lincoln City Council* [1999] 2 AC 349. That conclusion has since been restated, but with an important qualification, in *Test Claimants in the FII Group Litigation v Revenue and Customs Commissioners* [2020] UKSC 47. In that case, the Supreme Court held that time would run not from the date when the "truth" of the position has been established by an authoritative determination but from the date when the paying party ought through due diligence to have appreciated that it had a worthwhile restitutionary claim. At [213], the majority summarised the effect of their conclusions as follows:

> "Taking stock of the discussion so far, the position can be summarised as follows:
>
> (1) Limitation periods set a time limit for issuing a claim, which normally begins to run when the cause of action accrues. They apply whether the substance of the claim is disputed or not. They apply to claims regardless of whether there is in truth a well-founded cause of action.
>
> (2) Section 32(1) postpones the running of time beyond the date when the cause of action accrues, in cases where the claimant cannot reasonably be expected to know at that time the circumstances giving rise to the cause of action, by reason of fraud, concealment or mistake. Its effect is that the limitation period commences not on the date when the cause of action

accrues, but on the date when the claimant discovers, or could with reasonable diligence discover, the fraud, concealment or mistake.

(3) Consistently with (1) above, section 32(1) cannot be intended to postpone the commencement of the limitation period until the claimant discovers, or could discover, that his claim is certain to succeed.

(4) Consistently with (1) above, section 32(1) cannot be intended to postpone the commencement of the limitation period until the proceedings have been completed.

(5) In tying the date of "discoverability" of a mistake of law in section 32(1) to the date when "the truth" as to whether the claimant has a well-founded cause of action is established by a judicial decision, the decision in *Deutsche Morgan Grenfell* [2007] 1 AC 558 contravenes (3) above, and is therefore inconsistent also with (1) above.

(6) In tying the date of discoverability to the date of a judicial decision, with the consequence that the limitation period for issuing a claim may not begin to run until the proceedings have been completed, the decision in *Deutsche Morgan Grenfell* also contravenes (4) above, and is for that reason also inconsistent with (1) above.

(7) Tying the date of discoverability to the date of a decision by a court of final jurisdiction, as the House of Lords appear to have done in *Deutsche Morgan Grenfell* and as the Court of Appeal held in *FII (CA) 2*, compounds the mistake ….

…

(13) The purpose of the postponement effected by section 32(1) is to ensure that the claimant is not disadvantaged, so far as limitation is concerned, by reason of being unaware of the circumstances giving rise to his cause of action as a result of fraud, concealment or mistake. That purpose is achieved, where the ingredients of the cause of action include his having made a mistake of law, if time runs from the point in time when he knows, or could with reasonable diligence know, that he made such a mistake "with sufficient confidence to justify embarking on the preliminaries to the issue of a writ, such as submitting a claim to the proposed defendant, taking advice and collecting evidence"; or, as Lord Brown put it in *Deutsche Morgan Grenfell*, he discovers or could with reasonable diligence discover his mistake in the sense of recognising that a worthwhile claim arises."

430. Applying this test to the facts:

i) England and Wales is the contractual forum in which Venice's claims had to be brought.

ii) A noticeable feature of this case, therefore, is that the commencement of proceedings in the contractual forum could only challenge the position under

Italian law *as a matter of fact*, rather than by (for example) seeking to take the point to the Supreme Court to determine the position under English law.

iii) So far as the likely position in English proceedings is concerned as noted at [381] above, as late as 2015, Walker J rejected very similar arguments in the *Prato* case, and an appeal against the Article 119 aspects of that decision failed in 2017, both decisions not treating the Bologna Court of Appeal decision in *Cattolica* as sufficient. Those findings could have been given the status of prima facie evidence in any English proceedings (see [165(ii)), and in any event are likely to have strongly influenced any English judge. Indeed, given the terms of the Court of Appeal judgment quoted at [162], it is difficult to see how the claims would have been viable in the absence of a decision at a higher level.

iv) I have already explained at [276] my reasons for concluding that the decision of the Supreme Court in *Cattolica* represented a fundamental change in the interpretation of the relevant legislative and regulatory provisions.

v) For those reasons I am satisfied that, exercising reasonable diligence, Venice could not have discovered that it had a “worthwhile claim” prior to the *Cattolica* decision in the Supreme Court.

vi) It follows that none of Venice’s claims for restitution are time-barred.

R VENICE’S COUNTERCLAIMS

Introduction

431. Venice’s pleaded counterclaim alleges that:

i) The Banks owed Venice contractual and non-contractual advisory duties in relation to the entry into the Transactions.

ii) The Transactions were not suitable for Venice, and the Banks were thereby in breach of those contractual and non-contractual duties.

iii) Venice suffered loss as a result.

432. The counterclaim was not pleaded with great clarity, in part because of the attempt to refer to the pleading served by Venice in the Italian proceedings it had commenced against the Banks. In particular, the issues of causation were addressed only in exiguous terms. At the start of the trial, it became apparent that the Banks and Venice held different understandings as to whether those causation issues (and in particular the counterfactual issues of what would have happened if the Banks had done what Venice alleged that they were obliged to do) did or did not form part of the trial. For reasons set out in a ruling reported at [2022] EWHC 1656 (Comm), I held that those causation issues did indeed form part of the trial.

433. In the aftermath of that ruling, Venice chose not to pursue its claims for contractual damages, and confined its counterclaim to one for damages for breach of non-contractual obligations, namely its duties arising under Articles 21 of the Consolidated Law of Finance (**TUF**) and the regulation and guidance issued in relation thereto (although, as I explain below, the Banks still seek the declaratory relief they have sought

from the outset of the proceedings that they are not liable to Venice for breach of contract)

434. Venice confined its case as to the unsuitability of the Transactions to:

i) The allegation that they were unsuitable because they were unlawful as a matter of Italian law (**the Illegality Suitability Issue**).

ii) The allegation that they were unsuitable because of various features of the Transactions, including the negative MTM arising from the fixing of the terms on a basis which compensated the Banks for meeting the costs of winding up the Bear Stearns IRS and the effect on the economics of the Transactions which followed from that (**the Negative MTM Suitability Issue**).

435. In addition to this different subject-matter, there was an important difference between these two formulations so far as the issue of causation was concerned:

i) It was accepted that if the Banks had breached non-contractual obligations in relation to the Illegality Suitability Issue, then the appropriate counterfactual for the assessment of damages was one in which Venice had not entered into the Transactions, it being accepted that if Venice had been told that it would be unlawful for it to enter into the Transactions, it would not have done so.

ii) By contrast, if the Banks were found to be in breach of a non-contractual obligation in relation to the Negative MTM Suitability Issue, there was no such agreement, and Venice (for the reasons explained at [432] above) had adduced no evidence as to what it would have done in this scenario.

436. The Banks deny their liability to Venice on its counterclaim on the basis that:

i) The relevant non-contractual obligations were not governed by Italian law, as Venice's counterclaim assumes, but by English law.

ii) The Banks assumed no non-contractual duties to Venice as to the suitability of the Transactions.

iii) The Transactions were in fact suitable.

iv) Venice has failed to establish causation.

v) The counterclaim is time-barred.

437. I shall assume for the purposes of the analysis that follows that Venice is correct that the non-contractual obligations it relies upon were governed by Italian law, that the effect of those obligations was that the Banks owed non-contractual duties in relation to the suitability of the Transactions and that any duty in relation to the Negative MTM Suitability Issue was breached.

438. On the basis of those assumptions, I propose to consider whether:

i) Venice has established a breach of the assumed duty so far as the Illegality Suitability Issue is concerned?

ii) Venice has established that the assumed breach of duty in relation to the Negative MTM Suitability Issue has caused it loss?; and

iii) Venice's claims are time-barred?

Has Venice has Established a Breach of the Assumed Duty so far as the Illegality Suitability Issue is Concerned?

439. It was common ground that if such a duty was owed, it was not an absolute duty, but one which required the Banks to exercise due diligence. Venice's Note on Causation referred to its counterclaim as one for "damages for breach of the general duty of due diligence under Article 21(1) …. TUF". That characterisation was obviously correct. Article 21 of TUF expressly referred to intermediaries being required to "behave with diligence". In any event, it could not sensibly be suggested that although a lawyer providing specialist legal advice owed only a duty of reasonable skill and care, without warranting that the state of the law would eventually be found to match their advice, an intermediary providing investment and ancillary services would be under an absolute duty to ensure that the client could lawfully enter into the transaction.

440. On this issue, Mr Hobson (who presented this part of the closing argument on the Banks' behalf) submitted that:

i) any obligation on the part of a bank to assess suitability of the Transactions did not extend to determining whether it was lawful for Venice to enter into the Transactions; and in any event

ii) if there was such an obligation, it was at best one which required the Banks to act diligently, and it could not be said that the view that it was lawful for Venice to enter into the Transactions was one which could not diligently have been held in December 2007.

441. I am satisfied that the second of these arguments is correct, and that it provides a complete answer to Venice's suitability case so far as the alleged illegality of the Transactions is concerned.

442. There was no attempt to suggest that, if the Banks had acted diligently in 2007, they would have formed the opinion that the Transactions were unlawful from Venice's perspective. On the evidence before me, I am satisfied that this would not have been the case:

i) Both the Banks (through Clifford Chance) and Venice (through Beltramo) had access to Italian law advice when the Transactions were under consideration, and there is nothing to suggest advice was or ought reasonably to have been given at that time that the Transactions were unlawful.

ii) So far as Decree 389 and the 2004 MEF Circular are concerned, the view that there did not need to be an equivalence between the MTMs of the floor and cap in a collar transaction was clearly one which could reasonably be held in 2007, it being the view reached by Christopher Clarke LJ in 2014, Mr Justice Walker in 2015 and Mrs Justice Cockerill in 2021, and by Professor Napolitano before Walker J and Professor Gentili before me.

iii) I was shown no material which suggested that there was any court decision to the contrary effect at the time when the Transactions were entered into, still less material establishing that the contrary view could not reasonably have been held.

iv) So far as the various matters relating to Article 119, the Speculation Argument and the Article 42(2)(i) TUEL Argument are concerned, it is Venice's own case that "Venice did not know that the Swaps were prohibited by Italian law and/or that Mr Dei Rossi lacked actual authority to enter into them until *Cattolica*". Venice has also asserted in its Defence and Counterclaim that "Venice could not have known prior to *Cattolica* that the Transactions and Transaction Documents were not valid and enforceable in accordance with their terms". I see no reason for concluding that the Banks ought to have been in a different position.

Has Venice Established that the Assumed Breach of Duty in Relation to the Negative MTM Suitability Issue has Caused it Loss?

443. This aspect of Venice's case required it to establish that, as a matter of Italian law, there was a legal presumption of causation in the event that a financial or investment advisor breached its non-contractual duties in relation to the suitability of a transaction which the client had entered into, such that it did not matter that Venice had not adduced any evidence or advanced any positive case on that issue. I should note at this point that Venice only contended that it benefited from such a presumption in relation to its claims arising under Article 21 of TUF, and not in relation to its breach of contract claims (which no doubt explains why the breach of contract claims were not pursued).

444. No such presumption was pleaded by Venice, and it would appear to have surfaced for the first time in Venice's Note on Causation served on 1 July 2022.

445. As to this:

i) Professor Alibrandi accepted that the general rule as a matter of Italian law is that Venice as the claimant would have the burden of proving the causal link between breach and loss, and that general rule applies in cases of damages brought by an investor against an intermediary under TUF. Thus, Supreme Court Decision No 2350/2020 confirmed that the investor "has the burden of proving ... the financial loss resulting from the investment made and the causal link between the failure to comply and the alleged damage". Professor Alibrandi also observed that this rule (that the burden of proving causation lay on the claimant) was the one "usually applied" where the investor sought damages for breach of a TUF obligation.

ii) Professor Alibrandi noted that "in some cases" the Supreme Court had adopted a "less strict" approach and presumed loss. In particular, she referred to Supreme Court Decision No 33596/2021, in which the intermediary was in breach of a duty to provide information to the client. The Supreme Court noted that

> "in matters of financial intermediation, the information obligations incumbent on the financial intermediary are designed to encourage genuinely informed choices on the part of the investor, there being therefore a legal presumption as to the existence of a causal link between failure to

provide information and damage investor, in relation to which the intermediary may offer proof to the contrary...".

Professor Alibrandi also referred, without real discussion, to a case in which a similar approach had been adopted when the adviser was acting in a position of conflict of interest. The scope or rationale of any such exception was not explained, and it does not appear to me, at least, that Professor Alibrandi was seeking to support a wider principle of law that applied in suitability cases. Certainly, Professor Alibrandi did not point to any case in which this presumption had been applied in any suitability case.

iii) It was Professor Gentili's evidence that the burden of proof lay on Venice to establish causation. He was in agreement with Professor Alibrandi as to the general rule as referred to at i) but did not accept that there was any established exception to that principle in information cases. The question of whether there was any wider exception does not appear to have been touched on during the experts' discussions.

iv) Given the undisputed nature of the general principle, the tentative terms in which Professor Alibrandi referred to the fact that it had not always been applied, and the absence of any case reversing the burden of proof in a suitability case, I have not been persuaded that there is any principle of Italian law which would relieve Venice of its obligation to establish causation. Further, there is clearly a difference between a failure to provide the client with information to which the client is entitled for the purpose of forming its opinion, and a failure to offer advice to the client that in the intermediary's view, some aspects of the transaction made it unsuitable. In this latter context, the client may well have its own view about those particular features, and a desire to enter into a transaction which contains them. It is also understandable that a court might adopt a more favourable approach so far as the client is concerned when the adviser acts in a position of conflict of interest (English law, at least, laying some emphasis on the importance of clear rules with deterrent effect in this context). However, formulating a further exception in suitability cases would run into the difficulty of how this could be done without substantially eroding what is accepted to be the general rule.

v) I note the conclusion which I have reached is broadly consistent with that reached by Walker J in *Prato*, [2016] EWHC 2824 (Comm), [371]-[373].

446. It follows that Venice's claim for damages for the assumed breach of a non-contractual obligation as to the suitability of the Transactions so far as the Negative MTM Issue is concerned fails. I should stress that this was no technical failure. It was clear from the evidence I did hear that Venice was very interested in the short-term cashflow benefits the replacement to the Bear Stearns IRS offered, and that Ms Mutti's spreadsheets produced following the various first and second proposals had focussed on that issue and scored the Banks' proposal highly. I also accept that Venice would have been very unwilling to accept a proposal which required it to make an unbudgeted payment to close out the Bear Stearns IRS: that would have been inconsistent with the overall aim of the restructuring to realise savings, and by 26 October 2007 it had already allocated part of those anticipated savings in its budget. I accept that Mr Dei Rossi saw real attractions in signing up to terms which covered the cost of winding-up the Bear Stearns IRS, achieved a positive cashflow during the first half of 2008 and in the period up to

December 2008 and provided protection in the event of a market shock in the form of a significant rise in interest rates. It is also clear that Brady Italia, by the time they produced the Brady Report, did not regard the Transactions as unsuitable. There does not appear to have been any reaction by Venice to the passage in the Brady Report stating that the Transactions would "increase the market risk of the derivative in terms of 'overall effects on cashflows' resulting from the extension of the 15-year maturity and the change in the spread and floor".

447. Against that background, the evidence indicates that many of the features of the Transactions which are said to have made it unsuitable now were perceived very differently by Venice in 2007. Had the burden of disproving causation, contrary to my view, rested on the Banks, then in the absence of any explanation by Mr Dei Rossi as to what other transaction Venice would have entered into if it had not concluded the Transactions (questions of real difficulty which Venice has been able to avoid grappling with through its failure to adduce evidence on causation), I would have found that the Banks had done enough to move the evidential burden back to Venice.

Are Venice's Claims Time-Barred?

448. It follows from the conclusions I have reached that Venice's claim for damages in relation to the assumed non-contractual obligation on the Banks' part as to the suitability of the Transactions fails:

   i) in relation to the Illegality Suitability Issue, because there was no breach; and

   ii) in relation to the Negative MTM Suitability Issue, because there was no causation.

449. If the claims had survived this far, the issue would have arisen as to whether the claims were time-barred. It is common ground that under Italian law:

   i) There is a 10-year limitation period which applies in the absence of any contrary provision (Article 2946 of the ICC). It is common ground that this applies to claims in contract.

   ii) There is a 5-year limitation period for claims for damages arising from an unlawful act (which I shall refer to as torts) (Article 2947 of the ICC).

   iii) The limitation period runs from the date on which the claimant was first able to assert its right (pursuant to ICC Article 2935).

   iv) That date will be the later of: (i) when damage occurred, or (ii) when the claimant was in a position, using ordinary diligence, to be aware that it had suffered damage.

450. So far as the knowledge which would have been available to Venice using ordinary diligence is concerned, by 2008 at the latest it had received the Brady Report, and in a note produced on 25 June 2008, Venice noted the substantial negative MTM on its derivatives book (which must have been assembled from information available to Venice as to the substantial negative MTM on each of its swaps, including the Transactions). On 31 October 2008, Mr Dei

Rossi was instructed to approach lawyers to investigate possible avenues of redress in relation to the Transactions.

451. Faced with that difficulty, Venice raises two arguments in support of its contention that its claim for damages under Article 21 of TUF is not time-barred:

i) First, Venice contends that it is the 10-year limitation period rather than the 5-year tort limitation period which applies to claims for damages under the TUF.

ii) Second, Venice contends that time does not run for all its claims from the date when it was aware using ordinary diligence that it had suffered damage, but that a new and separate claim arose each time it made a payment to the Banks under the Transactions.

452. I am satisfied that Venice is wrong on both points, with the result that its claim is time-barred.

453. So far as the first argument is concerned, Venice relies on the following passage in Professor Alibrandi's first report:

> "216. Limitation period for damages (pre-contractual liability) – As better clarified above, the view traditionally taken by Italian case law and legal scholars is that pre-contractual liability qualifies as tort (ex delicto) liability, since it is not linked to the breach of existing contractual obligations.
>
> 217. It follows from that doctrine that the right to compensation for damage under Articles 1337 and 1338 is subject to the five-year limitation period laid down in the above-mentioned Article 2947 of the Italian Civil Code, (see the decision of the Court of Cassation No. 4051/1990; see also the Decision No. 5371/1987).
>
> 218. As explained in paragraph 197 above, the Court of Cassation has recently taken a different approach in Decision No. 14188/2016 and assimilated the pre-contractual liability provided for by Article 1337 and 1338 to the contractual liability and stated that the relating action for damages is subject to the general ten-year limitation period provided for by Article 2946 mentioned above".

454. This specifically addresses Articles 1337 and 1338 of the ICC:

i) Article 1337 is concerned with "negotiations and pre-contractual liability" and provides that "the parties, in the conduct of negotiations and the formation of the contract, shall behave according to good faith".

ii) Article 1338 is concerned with "Knowledge of causes of invalidity" and provides that "the party who, knowing or who should know of the existence of a cause of invalidity of the contract did not inform the other party of this, is required to compensate the damage suffered by this party for having trusted, without its fault, in the validity of the contract."

455. Both these provisions impose obligations of good faith on putative or actual contracting parties in dealings with each other intended to lead to a contract or where a contract

appears to have been concluded. The decisions relating to those provisions provide no support for a similar treatment of breach of the duties imposed by TUF on financial and investment advisors, and Professor Alibrandi does not suggest otherwise. On a fair reading of her evidence, the 5-year period traditionally favoured for pre-contractual tort claims applies, and it is not open to Venice to latch onto the evidence about Articles 1337 and 1338 in closing for the purpose of advancing the argument that a 10-year period applies to its non-contractual claims. Indeed, Venice's reply accepted the application of a 5-year limitation period to tort claims, which in context can only have been a reference to its Article 21 TUF claim (being the only tort claim it was advancing).

456. As to the second, I am satisfied that the event which (on Venice's case) constituted loss was entering into the Transactions themselves, not each payment. It was at the point of contracting that Venice came under liabilities to the Banks and did so pursuant to Transactions which immediately had a significantly negative MTM such that Venice would have had to pay a substantial sum to exit the Transactions. Consistent with that analysis, Venice has claimed loss and damage in this case not on the basis that each net payment it has to make involves a new cause of action with a new loss, but that it can now recover damages representing amounts paid to date and the estimated value of its future obligations. Indeed, if Venice's argument that each payment gave rise to a separate claim was correct, it would appear to be open to Venice to sue for any individual payment it had made even if the Transactions overall were profitable for it (cf the position under English law, *Hotel Portfolio II UK Limited v Ruhan and Stevens* [2022] EWHC 383, [279]-[282]).

457. Venice's argument on this second point is not supported by the evidence of Professor Alibrandi. The experts are agreed that time for a claim in restitution will run from the date of each payment, but that is a fundamentally different claim to one for non-contractual damages. It is easy to see why time will not run for a claim to reverse a particular unjust enrichment on a date prior to the date when that enrichment takes place. The only Italian cases relied upon by Venice in closing in support of its argument were:

i) Court of Venice Decision No 696/2022, a decision dealing with a claim in restitution referred to be the experts for that purpose; and

ii) a decision of the Court of Auditors of Lazio dated 11 April 2022 which did not form part of the expert evidence (and which only goes so far as to say that time runs from the *first* payment, rather than there being a separate limitation period for each payment, which would not assist Venice in any event).

458. Once again, I am satisfied that it is not open to Venice in closing submissions to seek to advance an argument of Italian law on this basis which is not supported by any expert evidence.

459. The effect of my conclusions is that Venice's claims for non-contractual damages are time-barred, and any claim by Venice for contractual damages would also have been time-barred, even allowing for the 10 year limitation period (these proceedings having been commenced on 15 August 2019, more than 10 years after Venice had consulted its lawyers in relation to the Transactions).

The Banks' Claim for a Declaration that they are Not Liable to Venice for Breach of Contract in Relation to the Entry into the Transactions

460. The Banks have sought declaratory relief to this effect from the outset of these proceedings. Against the background of the Italian proceedings which Venice has commenced against the Banks, a declaration as to the position might well be of utility, and Venice's decision not to pursue its contractual counterclaims is not of itself a sufficient reason not to make one.

461. It follows on my findings that:

   i) I am satisfied that the Banks have no liability in contract to Venice so far as the suitability of the Transactions is concerned.

   ii) Any claim on Venice's part against the Banks for breach of contract is time-barred in any event.

462. I am content to give declarations which will give effect to those findings.

S CONCLUSIONS

463. For the reasons I have set out above:

   i) Venice lacked capacity to enter into the Transactions on the basis of the Speculation and Indebtedness Arguments, with the result that they are void and unenforceable as a matter of English law.

   ii) Venice's challenges to the Transactions based on the Article 42(2)(i) TUEL Argument and breach of mandatory Italian law fail.

   iii) The Banks' arguments based on estoppel, breach of contract, misrepresentation or misstatement, Article 1338 of the ICC and the indemnity obligation in the Mandate Agreement fail.

   iv) Venice is entitled to restitution of the amounts paid to the Banks under the Transactions, but the Banks are in principle entitled to rely on a defence of change of position in respect of payments made under the "back-to-back" Hedging Swaps, subject to the reservations at [424] above.

   v) Venice's alternative claim for damages for breach of non-contractual obligations fails.

464. The parties are asked to consider what consequential orders and applications flow from those decisions, with a view to narrowing and delineating the issues which will arise for future decision.

465. I would like to conclude by expressing my considerable thanks to the legal teams for the high quality of their work in this very challenging case, which must have imposed enormous demands on all of them. A particularly pleasing feature of the case was that, in addition to the excellent work of leading counsel, Mr Hobson, Mr Paul and Mr Field all made significant and highly effective contributions to the oral presentation of their respective clients' cases in court. I look forward to hearing from Mr Wood in the course

of the consequential arguments. The increasing participation of junior members of advocacy teams in the oral presentation of cases in this court is welcome, and strongly encouraged.