Federal Supreme Court: negative interest in loan agreements

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AUTHORS

Sebastian Hepp

Markus Dörig

Introduction

The Federal Supreme Court recently dealt with the question of whether the interest payment obligation in loan agreements can be reversed due to the introduction of negative interest (4A_596/2018, 7 May 2019; unpublished).

The introduction of negative interest rates by the Swiss National Bank (SNB) in January 2015 has led to much uncertainty. The Federal Supreme Court's decision provides greater clarity with regard to loan agreements that were concluded before the London Interbank Offered Rate (LIBOR) base interest rate was shifted into the negative. The LIBOR is a reference interest rate determined in London, which is used as the basis for calculating the interest rate in loan agreements.

For the first time the Federal Supreme Court has held that, unless the parties have agreed otherwise, the obligation to pay interest under a loan agreement cannot be shifted to the lender.

Facts

The subject of this decision was a loan agreement entered into on 20 July 2006, in which the parties had agreed on a base interest rate (six-month LIBOR-CHF interest rate) plus a margin of 0.0375% per year. With the introduction of negative interest rates and the SNB's announcement of the cancellation of the CHF-EUR minimum rate in January 2015, the six-month LIBOR-CHF interest rate turned negative. In the case, the borrower requested the lender to freshly calculate the interest rate in accordance with the updated negative six-month LIBOR-CHF interest rate and pay the resulting negative interest. The borrower argued that the base interest rate was negative and that even taking into account the margin owed of 0.0375%, he would still be entitled to interest. The lender rejected the claim and argued that the loan agreement contained no explicit clause for the unexpected case that the six-month LIBOR-CHF interest rate turns negative. Accordingly, the borrower filed a lawsuit against the lender. The first and second-instance courts followed the interpretation of the contract of the lender and dismissed the borrower's lawsuit.

Decision

The Federal Supreme Court recalled that the interest is the remunerative counterpart for the provision of the credit during the contract period in loan agreements. According to this definition, a negative interest does not constitute an interest in the legal sense according to the Code of Obligations.(1) Further, the Federal Supreme Court pointed out that the borrower is obliged to return objects of the same quantity and quality to the lender according to Article 312 of the Code of Obligations.(2) A negative interest rate would therefore affect the equilibrium in loan agreements, as the interest rate would no longer represent the consideration for the provision of the credit. However, contracting parties are free to stipulate their own clauses in the loan agreement, as the relevant provisions in the Code of Obligations are not mandatory; however, the consequence of this is that the loan agreement will be qualified as an atypical loan agreement or an innominate agreement.(3)

As in the present case the contracting parties had not expressly agreed on the possibility of negative interest rates and the real intention of the parties could not be established, the loan agreement had to be interpreted objectively under the so-called 'principle of trust' under Swiss Law. The Federal Supreme Court referred to different doctrinal views on the consequences if the base interest rate

turns negative in loan agreements:(4)

- According to the first doctrine, the interest rate payable can never be lower than the agreed margin and the interest rate can therefore not fall below 0%. Thus, the margin is always owed to the lender and the lender must never pay interest rate to the borrower.(5)
- According to the second doctrine, the base interest rate can turn negative, but only up to the amount of the margin; a negative interest rate of more than the margin would thus reduce the interest to be paid by the borrower to 0%. Further, the lender must not pay interest rates to the borrower.(6)
- According to the third doctrine, the interest rate could fall under 0% by applying the contractually agreed formula, with the consequence that the borrower could demand interest payments from the lender as soon as the negative interest rate is higher than the margin. Accordingly, the lender must pay interest rate to the borrower.(7)

The Federal Supreme Court did not favour one doctrine over another. Rather, it held that the loan agreement in dispute did not contain an explicit clause for the event that the six-month LIBOR-CHF interest rate turned negative, nor did it explicitly guarantee an interest rate of 0.0375% in favour of the lender. Further, the loan agreement did not expressly contain a clause which would provide the possibility of reversing the interest payment obligation. In fact, several clauses of the loan agreement explicitly referred to the borrower's interest payment obligation. Moreover, according to the Federal Supreme Court, it is neither evident that the parties had expected negative interest rates when the loan agreement was concluded in 2006, nor that they intended that the borrower should be able to refinance himself using negative interest rates. Therefore, it cannot be inferred from an objective interpretation of the loan agreement that the borrower would receive negative interest payments in good faith.(8) Due to the absence of a counterclaim by the defendant, the Federal Supreme Court had to decide only whether negative interest was owed and it could therefore leave open the question of whether the lender – in connection with the interest formula – would in any case receive the margin of 0.0375% (the first doctrine) or whether this margin would fall to 0% due to the negative base interest rate (the second doctrine).

Comment

The Federal Supreme Court decision can be summarised as follows:

- As contracting parties are free to stipulate their own clauses, a loan agreement can contain a contractual provision with the possibility of reversing the interest payment obligation in case of the introduction of negative interest, but this requires a specific contractual clause. Since this was not the case in the present dispute, the reversal of the obligation to pay interest demanded by the borrower was not justified and, as a result, the borrower could not demand the payment of negative interest from the lender.
- Whether the negative base interest rate can lead to the elimination of the fixed margin or to a reversal of the interest payment obligation is a matter of contractual interpretation.

The reversal of the interest payment obligation for loan agreements concluded before the SNB introduced negative interest rates in January 2015 is likely to be the exception under the Federal Supreme Court's recent decision. Consequently, the question arises only in the case of loan agreements concluded after January 2015. For loan agreements concluded after this date, it can be assumed that the base interest rate, even if negative, will be included without restriction in the calculation of the interest rate. Therefore, it will be difficult for a lender to argue that it could not anticipate a shift of the interest rate into the negative after 2015. A court could hold that the lender should have addressed such a scenario with a specific clause in the loan agreement.

Nonetheless, the topic remains up to date as the LIBOR base interest rate is expected to expire in 2022. Once the LIBOR expires, all LIBOR-based contracts and loan agreements must be adapted to a new base interest rate. In future, the Swiss Average Rate Over Night (SARON) will most likely replace the LIBOR in Switzerland. The future will show how existing loan agreements based on the LIBOR will be adapted to the SARON. The complexity of this change should not be underestimated and will raise new legal issues regarding existing loan agreements and the renegotiation of the follow-up loan agreement.

For further information on this topic please contact Sebastian Hepp or Markus Dörig at BADERTSCHER Rechtsanwälte AG by telephone (+41 44 266 20 66) or email (hepp@b-legal.ch or doerig@b-legal.ch). The BADERTSCHER Rechtsanwälte AG website can be accessed at www.b-legal.ch.

Endnotes

(1) Federal Supreme Court 4A_596/2018, 7 May 2019, E. 3.3.

(2) Federal Supreme Court 4A_596/2018, 7 May 2019, E. 3.1.

(3) Federal Supreme Court 4A_596/2018, 7 May 2019, E. 3.5.2.

(4) Federal Supreme Court 4A_596/2018, 7 May 2019, E. 3.5.3.

(5) Maurenbrecher/Eckert, *Aktuelle vertragsrechtliche Aspekte von Negativzinsen*, in *GesKR* 2015, S. 369; Schärer/Maurenbrecher, in *Basler Kommentar*, 6 Aufl, 2016; Article 312 of the Code of Obligations, Rz 11; Hanns-Peter Kollmann, *Negative Zinsen, Eine rechtsökonomische Analyse,* 2016, S. 135; Wolfgang Ernst, "*Negativzinsen aus zivilrechtlicher Sicht - ein Problemaufriss*" in *Zeitschrift für die gesamte Privatrechtswissenschaft* 1/2015, S. 253; Federal Supreme Court 4A_596/2018, 7 May 2019, E. 3.5.3.

(6) Jean-Marc Schaller, *Negativzinsen im Aktiv- und Passivgeschäft von Banken, in Recht und Wandel, Festschrift für Rolf H Weber,* 2016, S. 266; Federal Supreme Court 4A_596/2018, 7 May 2019, E. 3.5.3.

(7) Corinne Zellweger-Gutknecht, "*Negativzins: Vergütung für die Übernahme des Geldwertrisikos durch den Kapitalnehmer*", in *Zeitschrift für die gesamte Privatrechtswissenschaft* 1/2015, S. 373; Federal Supreme Court 4A_596/2018, 7 May 2019, E. 3.5.3.

(8) Federal Supreme Court 4A_596/2018, 7 May 2019, E. 3.5.4.
