INTERNATIONAL FINANCE: SPRING 2010

Materials Packet 3

ISSUES IN SYNDICATED LOAN AGREEMENTS WITH INTERNATIONAL ASPECTS I

Caroline Bradley [1]

EURODOLLARS, EUROCURRENCY LOANS AND LIBOR

We will focus on the **eurocurrency** loan aspects of the facility agreement we are studying.[2] Please note the interest provisions of this loan facility agreement in particular sections 2.09, 2.10, 2.11 and 2.16 and the definitions section. The interest rate for eurocurrency loans is basically the eurocurrency rate plus a margin. In some loans the eurocurrency rate is described as Libor, which stands for "London Interbank Offered Rate" and is the rate of interest at which banks could borrow funds from other banks, in marketable size, in the London interbank market." Libor (here the eurocurrency rate) is the rate of interest which applies to eurocurrency deposits, which are deposits of currency outside the jurisdiction to which the currency belongs.[3] Originally, the currency in which eurocurrency deposits were denominated was the US dollar because there was significant interest in holding deposits denominated in dollars (because the dollar was the reserve currency), and some depositors had an interest in holding dollars

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[1] Professor of Law, University of Miami School of Law, PO Box 248087, Coral Gables, FL, 33124, cbradley@law.miami.edu ; http://blenderlaw.umlaw.net/ .

[2] US$ 1 bn Three-Year Competitive Advance and Revolving Credit Facility between Raytheon, Raytheon UK, certain financial institutions as lenders and JPMorgan Chase Bank, N.A., as administrative agent dated Nov. 18, 2009 *available at* http://www.sec.gov/Archives/edgar/data/1047122/000119312509241457/dex101.htm .

[3] "Formally, a eurodollar is a US dollar deposit, typically a 30-, 90- or 180-day time deposit, which is placed in a bank located outside the United States (often called a "eurobank"). Neither the nationality of the bank nor the location (or nationality) of the supplier of funds is relevant. What is relevant is the location of the bank accepting deposits. Thus, a US dollar deposit by a US manufacturing firm in a branch of a US bank in London is considered a eurodollar, while a US dollar deposit by a French company in a German bank in New York is not." BIS Quarterly Review, Sept 2004, p 68, note 2.

outside the US for various reasons. Later, eurocurrency deposits developed for other currencies (euroyen deposits, for example).

The term eurocurrency needs to be distinguished from the euro, which is the currency of some of the Member States of the European Union. The single currency is an aspect of economuic and monetary union in the EU. Originally 11 Member States formed the euro zone and it now includes sixteen of the twenty-seven Member States. The eurozone countries are Belgium, Germany, Ireland, Spain, France, Italy, Luxembourg, the Netherlands, Austria, Portugal, Finland, Greece, Slovenia, Cyprus, Malta and Slovakia. Members of the EU, and more specifically orf the eurozone, are supposed to co-ordinate their economic policies, but the financial crisis has exposed some weaknesses in the eurozone, most visibly with respect to Greece. In February 2010 the Council of the EU made the following statements about Greece:

The Council adopted:
– an opinion on the latest update by Greece of its stability programme, which sets out plans for reducing its government deficit below 3% of gross domestic product (GDP) by 2012;
– a decision giving notice to Greece to remedy its excessive deficit by 2012, setting budgetary consolidation measures according to a specific timetable, including deadlines for reporting on measures taken;
– a recommendation to Greece to bring its economic policies into line with the Union's broad economic policy guidelines and remove the risk of jeopardising the proper functioning of economic and monetary union (doc. 6145/10), and a decision to make this recommendation public.
Greece has been the subject of an excessive deficit procedure since April 2009, when the Council also issued a recommendation on corrective action to be taken. In December 2009, the Council stated in a decision that Greece had failed to comply with its recommendation.
Greece's government deficit for 2009 is put at 12.7% of GDP – well above the 3% reference value set by the EU treaty – in the Commission's autumn 2009 economic forecast and in Greece's updated stability programme. Its government debt at the end of 2009 is estimated to have been in excess of 113% of GDP, well above the 60% reference value for debt.
Moreover, shortcomings in Greece's public finance statistics have been a recurrent issue, prompting repeated calls by the Council on the Greek authorities, including in its April 2009 recommendation, to improve the collection and processing of its statistical data. In October 2009, Greece announced further substantial revisions of government deficit and debt data for previous years; the revised data has not been validated by Eurostat.
Greece's updated stability programme sets 2012 as the date for reducing the deficit below the 3% reference value. It sets a target of 8.7% of GDP for its 2010 budgetary deficit, which

represents a 4 percentage points reduction from the estimated 12.7% deficit for 2009.
In its decision, adopted under article 126(9) of the EU treaty, the Council accepts this schedule. It calls on Greece to ensure a budgetary adjustment of at least 4% of GDP in 2010 and to bring its deficit back under 3% in 2012 at the latest.
The Council sets numerical limits to Greece's government deficits and to annual changes in its consolidated gross debt in 2010, 2011 and 2012. It calls on Greece to implement specific budgetary consolidation measures, including those presented in its stability programme, namely:
– urgent measures to be taken by 15 May 2010;
– supporting measures to safeguard budgetary targets for 2010;
– other measures to be adopted by the end of 2010; and
– other measures to be adopted by 2012.
The Council also asks Greece to present a report by 16 March 2010 setting out the timetable for implementing budgetary target measures for 2010, and another by 15 May outlining the policy measures needed to comply with the Council's decision. Quarterly reports should be submitted thereafter.
To the extent that a number of risks associated with the specified deficit and debt ceilings materialise, Greece shall announce, in the report to be presented by 16 March 2010, additional measures to ensure that the 2010 budgetary target is met. In its recommendation, adopted in accordance with article 121(4) of the treaty, the Council finds that Greece's policies are not in line with the country-specific recommendation it issued under the broad economic policy guidelines (recommendation 2009/531/EC). In that recommendation, it had noted that it was "imperative to intensify efforts to address the macro-economic imbalances and structural weaknesses of the Greek economy".
The Council therefore calls on Greece to design and implement as soon as possible, starting in 2010, a bold and comprehensive structural reform package. It sets out specific measures, covering wages, pension reform, healthcare reforms, public administrations, the product market, the business environment, productivity and employment growth..[4]

When the eurodollar deposit market developed, interest rates for eurodollar deposits in London were higher than domestic interest rates in the US largely because domestic regulation of interest rates in the US did not apply in London.

Milton Friedman described eurodollars as follows:

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[4] Council of the EU, Press Release, 2994th Council meeting, Economic and Financial Affairs, Brussels, 16 February 2010 at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/112912.pdf.

...Euro-dollars ... are deposit liabilities, denominated in dollars, of banks outside the United States. ...Funds placed with these institutions may be owned by anyone- U.S. or foreign residents or citizens, individuals or corporations or governments. Euro-dollars have two basic characteristics: first, they are short term obligations to pay dollars; second, they are obligations of banking offices located outside the U.S....

A homely parallel to Euro-dollars is to be found in the dollar deposit liabilities of bank offices located in the city of Chicago-which could similarly be called "Chicago dollars." Like Euro-dollars, "Chicago dollars" consist of obligations to pay dollars by a collection of banking offices located in a particular geographic area....

The location of the banks is important primarily because it affects the regulations under which the banks operate and hence the way that they can do business. Those Chicago banks that are members of the Federal Reserve System must comply with the System's requirements about reserves, maximum interest rates payable on deposits, and so on; and in addition, of course, with the requirements of the Comptroller of the Currency if they are national banks, and of the Illinois State Banking Commission if they are state banks.

Euro-dollar banks are subject to the regulations of the relevant banking authorities in the country in which they operate. In practice, however, such banks have been subject neither to required reserves on Euro-dollar deposits nor to maximum ceilings on the rates of interest they are permitted to pay on such deposits.

The difference in regulation has played a key role in the development of the Euro-dollar market. No doubt there were minor precursors, but the initial substantial Euro-dollar deposits in the post-World War II period originated with the Russians, who wanted dollar balances but recalled that their dollar holdings in the U.S. had been impounded by the Alien Property Custodian in World War II. Hence they wanted dollar claims not subject to U.S. governmental control.

The most important regulation that has stimulated the development of the Euro-dollar market has been Regulation Q, under which the Federal Reserve has fixed maximum interest rates that member banks could pay on time deposits. Whenever these ceilings became effective, Euro-dollar deposits, paying a higher interest rate, became more attractive than U.S. deposits, and the Euro-dollar market expanded.

A third major force has been the direct and indirect exchange controls imposed by the U.S. for "balance-of-payments" purposes - the interest-equalization tax, the "voluntary" controls on bank lending abroad and on foreign investment, and, finally, the compulsory controls instituted by President Johnson in January 1968.[5]

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[5] Milton Friedman, The Eurodollar Market: Some First Principles, Selected papers No. 34, Graduate School of Business, University of Chicago, *available at* http://www.chicagogsb.edu/faculty/selectedpapers/sp34.pdf .

An article in the BIS Quarterly Bulletin for September 2004[6] says:

The geopolitical environment during the cold war and the regulation of US domestic banks in the 1960s and 1970s led oil-producing countries to search for a home outside the United States for their US dollar deposits. A long history as a global trade centre, coupled with a loosening of regulations on offshore transactions in the late 1950s, allowed London to emerge as the repository for these dollars. Over the past 30 years, US dollar deposits outside the United States, or "eurodollars", have grown exponentially, with London remaining at the centre of this market.

This growth in eurodollar deposits has been a function of the greater efficiency of eurobanks relative to banks in the United States. Because eurobanks face fewer regulations than their domestic counterparts (eg reserve requirements), they can operate at lower spreads and hence offer more competitive deposit and loan interest rates. With these lower operating costs, eurobanks have been able to attract deposits that would otherwise be placed in US domestic banks. As a result, the eurodollar market serves as an arena for the global recycling of funds, whereby eurobanks not only manage their own US dollar positions vis-à-vis other currencies, but ultimately place them in the hands of the global borrowers best able to use them.

The BIS noted a decline in the recycling rate of eurodollars in London - rather than remaining in the interbank market in London eurodollars were being lent to non-bank borrowers, mainly in the US.[7]

In the past Libor was not one fixed rate of interest, but could vary to reflect the different costs which different banks might incur in borrowing money in the interbank market. Loan agreements used to specify a process for calculating Libor for a particular loan, which would involve specifying which banks would be involved in quoting rates for Libor for different interest periods under the loan. Libor is supposed to reflect the lenders' cost of funds (the borrower under the loan agreement will pay Libor plus a margin where the margin is the lenders' profit on the loan). The use of Libor assumes that the lending banks will be funding their loan commitments from the interbank market rather than from deposits. Thus it is important that the rate quoted actually reflects the lenders' cost of funds. It is worth noting that the rates at which banks actually lend

[6] http://www.bis.org/publ/qtrpdf/r_qt0409g.pdf

[7] Libor has become an alternative to Prime Rate, which is the interest rate banks charge for short-term loans to their most creditworthy customers where there is little risk to the lender.

money to each other during any day will vary.

A bank which seeks to borrow money in the interbank market will need to pay a level of interest which reflects both prevailing market conditions and the lender's assessment of the borrowing bank's financial condition. Weaker banks would expect to pay higher interest rates. So a weak bank lender under a loan agreement which relied on strong banks to set Libor could find that the loan was unprofitable for it.

Libor is now a standardised rate of interest as the British Bankers' Association (BBA) developed a mechanism for fixing Libor for different currencies, and its rates are carried by various information providers (Reuters compiles Libor and publishes it through a number of data vendors, including Bloomberg and Thomson Financial, and a reference to the "screen rate" refers to these systems as the source for the rate).[8] You can also find Libor (for US $) quoted in the financial pages of the newspapers.[9] The facility agreement we are studying refers to the Reuters screen as the source for the eurocurrency base rate (or to any successor etc).

The BBA relies on Contributor Panels, which are groups of banks who quote rates for different currencies. BBA identifies the banks which compose the contributor panels. In 2008 commentators began to criticise the arrangements for fixing BBA Libor, because, although it was clear that banks were reluctant to lend to each other, BBA Libor did not increase to reflect this fact.[10] People speculated that banks quoting as part of the BBA's contributor panels were unwilling to reveal through the quotes they submitted to the Libor fixing process that other banks had lost confidence in them and were raising the rates they were demanding to lend money. If contributor banks were submitting inaccurate quotes then Libor quoted by the BBA would also be inaccurate as a reflection of actual rates of interest lenders might be expected to pay. The BBA responded to these concerns by reviewing its procedures and by strengthening the governance arrangements for the Libor fixing process. A consultative paper published

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[8] *See* http://www.bbalibor.com/bba/jsp/polopoly.jsp?d=1621 .

[9] Libor has been used as the basis for the interest rate in adjustable rate mortgages in the US domestic market.

[10] *See, e.g.*, http://uk.reuters.com/article/businessNews/idUKL2984225820080529?sp=true.

in June of 2008[11] was followed by a paper describing the new arrangements in November 2008.[12] The June paper described some of the issues as follows:

Transparency has long been one of the key attractions of LIBOR. Other indices either keep their contributors confidential (H15) or the bank is asked to contribute the rate at which it considers a hypothetical bank would borrow (EURIBOR). LIBOR contributors on the other hand provide the rate at which they believe they could borrow should they propose so to do. The issue has been raised as to whether this has the potential to stigmatise contributions and therefore the BBA proposes to explore options for avoiding any stigma whilst maintaining transparency...
BBA LIBOR is by far the most widely referenced interest rate index in the world. Its importance goes beyond that of inter bank lending and touches everyone from large international conglomerates to small borrowers. It is central in interest rate swaps and the great majority of floating rate securities and loans relate to LIBOR. Independent research indicates that around $350 trillion of swaps and $10 trillion of loans are indexed to BBA LIBOR. It is the basis for settlement of interest rate contracts on the world's major futures and options exchanges. It is written into standard derivative and loan documentation such as the ISDA terms and is also used for an increasing range of retail products...
LIBOR is owned by the BBA which is a not for profit organisation funded primarily by subscriptions from its voluntary members. The data for the LIBOR fixes is compiled and calculated by Reuters for the BBA. The contributing banks for each LIBOR currency are selected on objective criteria and may or may not be members of the BBA. Those who are members they pay an annual standard subscription to the Association. There is no levy charged for any bank which contributes to or participates in the LIBOR fix...
LIBOR has an unbroken back-history stretching back to 1985 and it has enjoyed an enviable reputation since its inception.[13]

The new arrangements involve a committee, the Foreign Exchange and Money Markets Committee (FX & MM Committee), with two sub-committees, one of which is

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[11] BBA, Understanding the Construction and Operation of BBA LIBOR - Strengthening for the Future (Jun. 10, 2008) *available at* http://www.bba.org.uk/content/1/c6/01/38/99/BBA_LIBOR_strengthening_paper.pdf .

[12] See BBA, LIBOR Governance and Scrutiny - Proposals agreed by the FX & MM Committee (Nov. 17, 2008) *available at* http://www.bba.org.uk/content/1/c6/01/50/87/LIBOR_paper_-_FINAL.pdf .

[13] The paper explains that "H15 is the yield in the three month Euro Dollar deposit rate published daily by the Fed. The Fed's measure of USD Euro Dollar rates is based on the yield observed within the Euro Dollar deposit market and the H15 values had tended to be at the high end of the traded range."

responsible for fixing Libor, and the other of which is responsible for oversight. There are new disciplinary procedures. In contrast to past practice the names of the firms which are represented on the committee are disclosed, and the firms are chosen to reflect a range of different interests:

> Currently Committee members sit in their own right as individuals, and membership is not publicly disclosed. However there is justifiable interest from the market in the make-up of the Committee, as they wish to see that the body is independent and appropriately constituted...
> In future, therefore, committee members will sit as individuals representing their firms, and will be expected to act in the best interests of the LIBOR benchmark and the markets it serves. The committee will be expanded to include:
> A representative of a (currently) non-contributing US bank that is active in the money markets
> A representative of a (currently) non-contributing European bank that is active in the money markets
> One representative from Liffe and one from the Chicago Mercantile Exchange (CME)
> Two "rate takers": one from the fund management industry and one from the Association of Corporate Treasurers...
> The BBA will contact the above and present a list of names and titles for consideration by the Committee...
> Once the Committee has reached its complement, the names of all firms represented will be released, but not names of the individual members. This will be accompanied by a statement which describes the capacity in which members serve...
> The BBA is subject to a regular independent audit of practices and processes and in future the FX & MM Committee and LIBOR processes will be included in this audit.[14]

These changes to the governance arrangements for the Libor fixing process are similar to recent changes to exchange governance arrangements (in the inclusion of representation of a wider range of interests).

For the euro there is an interest rate called Euribor (Euro Interbank Offered Rate) which is "the rate at which euro interbank term deposits within the euro zone are offered by one prime bank to another prime bank."[15] and, like BBA Libor, is fixed by a panel of banks. The Euribor Code of Conduct specifies the rules that apply to Euribor

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[14] LIBOR Governance and Scrutiny at p. 6.

[15] http://www.euribor.org/

and panel banks.[16]

Consider how the facility agreement addresses issues associated with reliance on funding in the interbank market.

The margin specified in the facility agreement is to vary with the credit default swap spread which is the cost per annum for protection against a default by the company.

CONTRACTS AND UNCERTAINTY: DEFAULT INTEREST, FREEZES

Loan Agreements typically apply a higher rate of interest to borrowers after any default in payment. For a case stating that a 1% default interest provision did not constitute a penalty because it was a modest increase and reflected the increased risk for the lenders after a default by a borrower see **Lordsvale Finance plc v Bank of Zambia** [1996] 3 All ER 156 (QBD, Colman J.)[17]:

... Where, however, the loan agreement provides that the rate of interest will only increase prospectively from the time of default in payment, a rather different picture emerges. The additional amount payable is ex hypothesi directly proportional to the period of time during which the default in payment continues. Moreover, the borrower in default is not the same credit risk as the prospective borrower with whom the loan agreement was first negotiated. Merely for

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[16] It can be found at http://www.euribor.org/html/content/euribor_code.html

[17] Compare, e.g., *Norwest Bank Minn., N.A. v. Blair Rd. Assocs., L.P.*, 252 F. Supp. 2d 86 (District of New Jersey 2003) (rejecting argument that a default interest provision was a penalty: “Where enforceable, a stipulated damages clause is referred to as liquidated damages... Nevertheless such a clause requires judicial scrutiny because it may constitute an oppressive penalty and hence be unenforceable...a default interest rate, like late fees, is subject to the test of reasonableness.”); cf. *Cantamar, L.L.C. v. Champagne*, 2006 UT App 321 (“We conclude the 30% per annum default interest rate agreed to by DSI under the terms of the Note is not substantively unconscionable. In light of DSI's execution of prior notes with previous lending companies, DSI was not an inexperienced party to such agreements... and cannot claim surprise, particularly where the default interest rate under the Note was lower than the interest rates of the two prior notes the Note refinanced. Additionally, because the Note constituted a refinancing of DSI's prior obligations under two earlier promissory notes to a different lender, including unpaid interest and fees, Cantamar assumed more than a minimal amount of risk in refinancing DSI's earlier loans. Even presuming the Note's default was "high by some standards," the Utah Supreme Court has previously explained that "[a]cquisition of high risk capital almost always requires the payment of a premium," and thus "[i]t is not sound legal policy to establish rules so strict as to unnecessarily dampen legitimate and desirable business activity.")

the pre-existing rate of interest to continue to accrue on the outstanding amount of the debt would not reflect the fact that the borrower no longer has a clean record. Given that money is more expensive for a less good credit risk than for a good credit risk, there would in principle seem to be no reason to deduce that a small rateable increase in interest charged prospectively upon default would have the dominant purpose of deterring default. That is not because there is in any real sense a genuine pre-estimate of loss, but because there is a good commercial reason for deducing that deterrence of breach is not the dominant contractual purpose of the term.

It is perfectly true that for upwards of a century the courts have been at pains to define penalties by means of distinguishing them from liquidated damages clauses. The question that has always had to be addressed is, therefore, whether the alleged penalty clause can pass master as a genuine pre-estimate of loss. That is because the payment of liquidated damages is the most prevalent purpose for which an additional payment on breach might be required under a contract.

However, the jurisdiction in relation to penalty clauses is concerned not primarily with the enforcement of inoffensive liquidated damages clauses, but rather with protection against the effect of penalty clauses. There would therefore seem to be no reason in principle why a contractual provision, the effect of which was to increase the consideration payable under an executory contract upon the happening of a default, should be struck down as a penalty if the increase could in the circumstances be explained as commercially justifiable, provided always that its dominant purpose was not to deter the other party from breach.

In **Murray v Leisureplay plc** (2005)[18] the English Court of Appeal had to consider the question whether a contractual provision for damages in an employment contract functioned as a penalty. Lady Justice Arden said:

29 The penalty issue is one of considerable jurisprudential interest. English law is well-known for the respect which it gives to the sanctity of contact. The question which the law of penalties poses is this: to what extent does English contract law allow parties to a contract to specify for their own remedies in damages in the event of breach? The answer is that English law does not in this particular field take the same laissez-faire approach that it takes to (for example) the question whether parties can agree to time limits for the performance of obligations which they subsequently find difficulty in meeting. So far as that is concerned, pacta sunt servanda. So far as pre-determined damages clauses are concerned, English contract law recognises that, if the parties agree that a party in breach of contract shall pay an unjustifiable amount in the event of a breach of contract, their agreement is to that extent unenforceable . The reasons for this

[18] [2005] EWCA Civ 963 at http://www.bailii.org/ew/cases/EWCA/Civ/2005/963.html

exception may be pragmatic rather [than] principled....
43 The usual way of expressing the conclusion that a contractual provision does not impose a penalty is by stating that the provision for the payment of money in the event of breach was a genuine pre-estimate by the parties to the agreement of the damage the innocent party would suffer in the event of breach. As Lord Dunedin said in the Dunlop case, the "essence" of a liquidated damages clause is "a genuine covenanted pre-estimate of damage" ... As the Dunlop case and the citation from the Philips case... show, a contractual provision does not become a penalty simply because the clause in question results in overpayment in particular circumstances. The parties are allowed a generous margin..
54 With the benefit of the citation of authority given above, in my judgment, the following (with the explanation given below) constitutes a practical step by step guide as to the questions which the court should ask in a case like this:-
i) To what breaches of contract does the contractual damages provision apply?
ii) What amount is payable on breach under that clause in the parties' agreement?
iii) What amount would be payable if a claim for damages for breach of contract was brought under common law?
iv) What were the parties' reasons for agreeing for the relevant clause?
v) Has the party who seeks to establish that the clause is a penalty shown that the amount payable under the clause was imposed in terrorem, or that it does not constitute a genuine pre-estimate of loss for the purposes of the Dunlop case, and, if he has shown the latter, is there some other reason which justifies the discrepancy between i) and ii) above?
55 A point that neither the Dunlop case nor the Cine case considers is the position if either there is no evidence at trial as to why the parties agreed a particular clause, or if the evidence is that they did consider it but took a wholly wrong view about what damages would be payable under the general law in the event of breach. In the Dunlop case, trial had taken place and there had been evidence as to why Dunlop needed the clause. In the Cine case, trial had not take place but the court proceeded on the basis that there would or could be evidence about the reasons for the clause in question at the trial to which the case was remitted. What happens if there is no evidence about the reasons for the clause? There would in my judgment be no reason why the court could not draw inferences of fact as to the reasons and as to the genuineness of those reasons. What if it appears from the evidence that is given (or from the inferences that the court makes from the facts) that the decision to include the damages clause was included on the basis of a mistaken belief that the damages at common law would be assessed on a materially more generous basis than in fact would occur? This would be the case if for example the parties failed to have regard to the fact that a party would have to give credit for a benefit that he obtained on breach, such as a tax saving as a result of the receipt of damages for lost income in the form of a lump sum payment of damages. In my judgment, the good faith belief of the parties is not the deciding factor here. The court would look at the result and (bearing in mind that the onus is on the party challenging the clause to establish that it is a

penalty) ask whether it is satisfied that the parties could not, if they had had the proper information or considerations in front of them, genuinely have considered that the damages payable under the contractual provision were a realistic pre-estimate of the damages payable on breach at common law. In other words, in the context of Lord Dunedin's speech, the test of genuineness is objective. A pre-estimate is genuine if it is not unreasonable in all the circumstances of the case.

The other two judges in the case took what they described as a broader view in which they approved of the approach of Colman J. in the Lordsvale Finance case and also suggested that courts should be more reticent about invalidating contractual provisions than Lady Arden's judgment suggested. For example, Lord Justice Buxton said:

116 It is therefore necessary to stand back and look at the reality of this agreement. Although I agree that evidence about it is sparse, I am prepared to take judicial notice of the fact that an entrepreneurial company such as MFC, promoting a product conceived by one man, will often place a high value upon retaining the services, and the loyalty and attention, of that one man as its chief executive: to the extent of including in his "package" generous reassurance against the eventuality of dismissal. That such reassurance exceeds the likely amount of contractual damages on dismissal does not render the terms penal unless the party seeking to avoid the terms can demonstrate that they meet the test of extravagance posited by Lord Dunedin and by Lord Woolf. I regard that as a comparatively broad and simple question, that will not normally call for detailed analysis of the contractual background. Applying that test, which I accept differs from that adopted by my Lady, I would accordingly allow the appeal on the penalty issue.
117 I would add this. The difficulty that the court has in identifying a penalty in an orthodox commercial contract is demonstrated by the outcome of the Dunlop case itself. The clause in question was a standard form, imposed on all of Dunlop's customers, that required the payment of five pounds by way of "liquidated damages" if the customer did any one of the acts of tampering with marks on the goods; selling at under list price; supplying to persons blacklisted by Dunlop; or exporting without Dunlop's consent. Contrary to what would be thought today, the House did not view the fact that the clause was part of a contract of adhesion as undermining its status as an agreement freely bargained for... The clause imposed a single payment for any of a varied series of breaches; but assisted by Dunlop's evidence as to the benefits to the company of the price maintenance policy (expressly so described) that the clause imposed, as set out in particular by Lord Atkinson in both the Dunlop cases, the House concluded that an explanation of the clause in commercial rather than deterrent terms was available. That commercial explanation lay in Dunlop's desire enforce its commercial policy without the difficulty and burden of proving the quantum of damage accruing from every particular breach of that

policy.

118 Dunlop differed from the present case in that the House was impressed by the difficulty of proving an exact loss in every, or any, of the many cases of breach to which the clause extended. That particular problem does not affect our case. But the cautious approach of the House, and its willingness to look at the clause in its commercial context, does at least underline the importance stressed by Lord Woolf of not moving automatically from the fact that a clause could result in greater recovery than the amount of the actual loss to an assumption that without further justification the clause must be penal in nature.

The issue of penalties arose again in December 2009 in litigation involving currency swaps under an ISDA Master Agreement in **BNP Paribas v Wockhardt EU Operations (Swiss) AG:**[19]

1 BNP Paribas, the claimant ("BNP"), has a branch in Mumbai. The defendant – Wockhardt EU Operations (Swiss) AG ("Wockhardt") – is a Swiss company and a wholly owned subsidiary of Wockhardt Ltd, an Indian company, based in Mumbai. Wockhardt Ltd is a leading pharmaceutical and biotechnology company – the largest Indian pharmaceutical group in Europe. BNP has an established banking relationship with Wockhardt Ltd.

2 In April 2008 BNP and Wockhardt entered into a Master Agreement in the standard form of the International Swap Dealers Association (ISDA) with accompanying Schedule dated as of 20 July 2007. A number of transactions were entered into pursuant thereto. Those transactions fall, so far as presently relevant, into two categories.

3 In the first category were foreign exchange target redemption forward transactions. By these transactions, so far as presently relevant, BNP sold euros to Wockhardt for dollars. In the second category were a number of foreign exchange forward transactions. These were transactions under which Wockhardt agreed to buy from BNP on a series of settlement dates an amount of either Euros or dollars (the amount being established by reference to a notional amount in Euros) for dollars or euros as the case might be at a defined rate of exchange....

10. By a demand in writing dated 22 April 2009, BNP provided to Wockhardt a Statement of Calculations pursuant to clause 6(d)(i) of the Master Agreement, showing the Early Termination Amount payable by Wockhardt ("the Early Termination Amount"), which then stood at US$2,150,570.10. To that sum was added default interest which had accrued from 2 April to 22 April 2009 in the sum of US$1,503.06. The total sum of US$2,152,073.16 was due and payable immediately.

11. The Early Termination Amount claimed by BNP was, apart from interest, made up of two elements:

[19] [2009] EWHC 3116 (Comm) at http://www.bailii.org/ew/cases/EWHC/Comm/2009/3116.html

(a) unpaid amounts already due under specific forward deals amounting (as at 22 April 2009) to US$1,260,090 ("the Unpaid Amounts") and

(b) a Close-out Amount of US$890,480 ("the Close-out Amount")....

22. Mr Antony White QC on behalf of Wockhardt submits that it has an arguable case that the provisions relating to an Early Termination Amount are unenforceable by reason of the doctrine relating to penalties. The Early Termination Amount is a sum payable upon breach following the giving of a Notice of Default and a failure to pay within a very short period after notice of an earlier failure. The full Early Termination Amount is payable (i) whether the defaulting party has one open transaction or many open transactions; (ii) whether the default occurs early in the life of a Transaction or towards the end of its life; (iii) whether the default is a small default on one Transaction, a large default on one Transaction or a large default on many or all Transactions; and (iv) the amount of the Early Termination Amount cannot be predicted at the time of entering into the Transactions as it depends on upon market fluctuations. For all these reasons the provisions providing for an Early Termination Amount, at any rate in relation to the Close-out Amount are penal. They do not provide for a genuine pre-estimate of the loss but for payment of the same amount on the occurrence of any one of a number of possible breaches which may give rise to widely different consequences. At any rate there is a realistic argument that that is so

23 In considering the potential application of the doctrine of penalties the authorities provide a number of guidelines. The ISDA Master Agreement is very widely used in international financial markets in all types of derivative transactions. That does not mean that its standard provisions may not be penal but the consequences of that being so means that the sooner the issue of its validity is determined the better...

24 The desirability of a prompt determination cannot alter the test as to whether some form of summary judgment should be given, but:

".. on general principles the court should not be astute to interpret commercial transactions so as to invalidate them, particularly when . consequential doubt might be cast on other long-standing commercial arrangements": Perpetual Trustee Co Ltd v BNY Corporate Trustees Services and another; Belmont Park Investments Pty Ltd v Corporate Trustee Services Ltd and another [2009] EWHC 1912 (Ch) per Sir Andrew Morritt, QC.

"It is also desirable that, if possible, the courts give effect to contractual terms which the parties have agreed. Indeed there is a particularly strong case for party autonomy in cases of complex financial instruments ." per the Master of the Rolls at para 58 of the Butters appeal [2009] EWCA Civ 1160.

".the power to strike down a penalty clause is a blatant interference with freedom of contract and is designed for the sole purpose of providing relief against oppression for the party having to pay the stipulated sum. It has no place where there is no oppression"; per Dickson J in the Supreme Court of Canada in Elsey v J.G. Collins Insurance Agencies Ltd [1978] 83 DLR 1, p 15. , approved by the Privy Council in Phillips Hong Kong Ltd v AG of Hong Kong [1993] 61

BLR 49, p 58.

25 The policy of the law is to encourage the use of liquidated damages clauses especially in commercial contracts: Murray v Leisureplay plc [2005] EWCA Civ 963, para 114 citing Diplock, LJ in Robophone v Blank [1966] 1 WLR 1428, 1447.

26 Lord Dunedin classically described a penalty clause as one which stipulates a pre-defined sum payable on one or more breaches of contract "if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach": Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd [1915] AC 79, 87. In the same case he said that there was a presumption (but no more) that a clause is a penalty when 'a single lump sum is made payable by way of compensation on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage". In such a case the court may look to see whether or not the sum is disproportionate to the least important of the contractual undertakings to which it applies and thus whether it represents an extravagant or unconscionable sum in relation to such a breach.

27 In the present case the clause pre-defines not the sum, but the method by which a sum - the Early Termination Amount, is to be determined and by whom. The fact that it prescribes a method would not save it from being a penalty if the result of the application of the method was to produce an amount which was extravagant and unconscionable in the respects described by Lord Dunedin. The fact that it does not contain a pre-estimate in the sense of a fixed figure or one easily determinable by a specified formula (as opposed to a criterion) does not mean that it must, on that account, be penal.

28 In order to determine whether the clause is penal in consequence it is necessary to consider what is due to BNP following termination in consequence of the breach.

29 So far as the Unpaid Amounts are concerned, they had already fallen due before termination under individual forward transactions. There is nothing penal in requiring Wockhardt, the defaulting party, upon a termination following an Event of Default, to pay amounts that were already due but unpaid prior to the termination. # So far as the Close-out Amount is concerned the critical question, to my mind, is whether or not non-payment of any amount due on delivery amounts to a breach of condition by virtue of which BNP is entitled to treat itself as discharged from its obligations under the contract and entitled to damages for the loss of its bargain upon the footing that the contract has come to an end by virtue of Wockhardt's default.

30 Mr White submits that that is not, or at least arguably is not, the position here since the parties have not specified that punctual payment of each amount due was a condition, or non-payment a repudiatory breach, and there is no need for that to be implied.

31 I disagree. Whilst the parties have not used the expression "condition" or "repudiatory breach" they have specified that any failure to pay which continues after the first Local Business Day after notice of failure will entitle BNP to designate an Early Termination Date; and have

gone on to provide that upon an effective designation no further payments or deliveries (the primary obligations under the contract) will be due. Wockhardt's obligation to make future payments against deliveries will, therefore, cease as will BNP's obligations to make deliveries against payment. In the place of those obligations there is to be substituted an obligation on the part of Wockhardt, the defaulting party, to make a payment which represents the cost of replacing the Terminated Transactions or in providing the economic equivalent of those Transactions. The former would, no doubt, need to take into account any price to be paid for replacing the terminated transactions as at the Early Termination Date. The latter would involve a determination of the value as at the Early Termination Date of the remainder of the contract i.e. the present value, allowing for the time value of money, of putting BNP into the same position as it would have been in if the uncompleted sales of euros had gone ahead according to their terms. These are two methods of putting BNP into the same position it would have been if the contract had not been validly terminated on account of Wockhardt's breach. Neither of them provides for an extravagant or unconscionable measure if what is being measured is BNP's loss of bargain.

32 In providing for BNP's entitlement to terminate the ongoing primary obligations of the parties and the method of calculation of the sum to be paid in that event, the parties have, subject to one qualification, spelt out the consequences which result from a breach of condition. It is unrealistic to suppose that, having done so, they are to be taken to have intended that a failure to pay should be regarded as a warranty or an innominate term, particularly in the light of the Pre - Estimate clause which (see above) provides that the amount recoverable under clause 6 (e) is payable for the non Defaulting Party's loss of bargain and the loss of protection against future risks. Commercial parties to a contract for the sale and delivery of currency who specify that non-payment or non-delivery shall have the consequences which would follow from a breach of condition, both as to entitlement to terminate and measure of recovery, must be taken to have agreed that the term in question shall have that status. The expressions "condition" and "repudiatory breach" are legal shorthand for a term breach of which entitles the innocent party to terminate the contract and to claim damages for loss of bargain or a breach which has those consequences. When the parties have expressed those consequences for themselves they have no need of the shorthand.

33 Whilst by section 41 of the Law of Property Act 1925 stipulations as to time which "according to rules of equity are not deemed to be or to have become of the essence of the contract are also construed and have effect at law in accordance with the same rules" time is held in equity to be of the essence of the contract "in cases of direct stipulation or of necessary implication": per Sir John Romilly M.R in Parkin v Thorold [1852] 16 Beav 59, 65; and that implication can arise from the nature and content of the contract.

34 Mr White submitted that to hold that the doctrine of penalties was not applicable because the contract specified the consequences of breach was to misunderstand the rule. Where the doctrine is applicable it takes effect notwithstanding that the contract provides for the payment

in question. That does not, however, mean that the court is disabled from construing the nature of the obligation which the parties have agreed on from an examination of (i) the obligation in question (here payment against delivery) and (ii) the consequences which the parties have agreed shall follow on fulfilment (termination at the option of BNP and compensation for loss of bargain).

35 A clause prescribing the damages payable upon breach could still be a penalty if it prescribed an extravagant payment even for a breach of condition: see Lombard PLC v Butterworth [1987] QB 527, 535, proposition 7. The present clause does not, however, do so.

36 The qualification is that the Early Termination Sum is a calculation of the net position between the parties as at the date of termination in relation to Terminated Transactions. The defaulting party will thus, in any event, be entitled to credit for any positive present value in its favour in respect of those transactions. The valuation does not necessarily result in sums becoming payable from the defaulter to non-defaulter; they can be payable in either direction. No doubt BNP will not be inclined to terminate the agreement if, upon its so doing, it would not receive any sum, unless, perhaps, it thought that a later termination might put it in a position where it would have to pay out even more. What it cannot, however, do is to refuse to credit Wockhardt with any overall net balance in its favour upon the ground that it was discharged from all future performance. Since that is something which redounds to Wockhardt's advantage it cannot be relied on as making the provisions penal.

37 The effect of the provisions is not that either party receives a windfall but that both receive the benefit (or disbenefit) of the unperformed transactions comprising their agreement crystallized at an earlier point in time (of the Non Defaulting party's choosing). Whilst the analogy is not exact, since the amount, if any, payable as an Early Termination Amount (and thus the total value of the performance remaining) will change throughout the life of the agreement in line with market fluctuations, there is nothing penal in a provision which requires the acceleration in the event of breach of an amount which, without breach, would become due later: Protector Endowment Loan Co v Grice (1880) 5 QBD 592; The Angelic Star [1988] I Lloyd's Rep 122, 125-7.

38 The clause does not become unconscionable or extravagant simply because it provides for a determination of what is to be due to be made by the Non Defaulting party, particularly when it requires BNP to "act in good faith and use commercially reasonable procedures in order to produce a commercially reasonable result."...

44 Mr White submitted that in the present case there were two indicators of the penal nature of the provisions which required the Court to consider their commercial justification e.g., by considering their genesis, the nature of the negotiations or considerations that had led to them, and the problems, if any, which they were designed to address. Such a consideration was inappropriate for a summary process; and, indeed, there was very little evidence of the reasonableness of the provision. The first indicator was that the same sanction – the close out of the Transactions – was exigible for breaches of very different seriousness. The second was

that the clause provided for the payment of a fluctuating amount since the sum to be paid would alter according to market rates or volatility, matters which were extraneous to the breach.

45 I do not accept this submission. The fact that the clause is capable of application to several breaches of different seriousness might well be an indicator that it was penal in character but for the fact that, in my judgment, the provision of timely payment is a condition of the agreement. The fact that the amount to be paid will fluctuate according to the movements of the market is not something extraneous to the breach. It is a circumstance that must necessarily be taken into account in determining the present value of the contract at any given time.

46 Reliance was placed on the decision in Public Works Commissioner v Hills [1906] 1 AC 368 where a railway construction contract provided that in the event of a breach by the contractor he should forfeit "as and for liquidated damages" certain percentages retained by the Government of the Cape of Good Hope of money payable for work done as a guarantee fund to answer for defective work and also certain security money deposited with the Government. The amount of that retained money depended on the progress of contracts other than the one in suit. That was an example of a liquidated damages clause whose operation was dependent on facts which had nothing to do with the relevant breaches. But that is a circumstance far removed from this case.

47 I was also referred to the observations of Thomas, LJ at paragraph 49 in Cine Bes Filmcilik Ve Yapimcilik & Anr v United International Pictures & Ors [2003] EWCA Civ 1669 that "a decision on whether [a clause] is penal involves a careful examination of the circumstances which is not possible on a Part 24 application". I do not, however, understand him to have laid down that a summary decision in relation to whether a clause is penal is always inappropriate. In that particular case the clause failed to give credit for rights to films for which payment would have been made against sums payable on termination; and that was regarded as a circumstance which required justification or, at least an examination as to whether or not its effect was penal. That feature does not arise here.

48 Mr White directed my attention to a passage in The Law on Financial Derivatives, 4th edition para 3.11 where Professor Hudson refers to the "artificial link" between the transactions constituted by the provision in the Master Agreement that all of the Confirmations entered into between two parties together with their Master Agreement, Schedule and Credit Support documentation are construed as constituting one single contract. The reason, as he points out, for introducing this artificial link is so as to secure that on the termination of the relationship between the parties it is possible to set off all of the amounts owed between the parties and to come to one final, net sum which will settle all of the exposures of the parties one to another, a provision which may assume very great importance upon insolvency. The link is designed to avert the risk that the solvent party may be required to make payment of all amounts which it owes but not be entitled to recover, save through the relevant insolvency process and to the extent that there is a sufficiency of assets, the amounts due to it.

49 The fact is, however, that the parties have created that link by their agreement, as they

were entitled to do. Their intention, as manifested in the language which they have used, is that the Master Agreement and all Confirmations shall form a single agreement between the parties, and that prompt payment in respect of each individual transaction shall be an essential term of that agreement. There is, in my judgment, no reason why a commercial contract such as this should not take effect in accordance with its terms; nor anything particularly surprising in a provision which makes payment of the debt within a day of notice of failure a condition. Mr White submitted that, if the link between transactions was artificial, the doctrine of penalties was engaged because that doctrine was concerned with substance. But, in truth, there is nothing artificial about the agreement of the parties. They have by agreement produced a situation which, in the absence of their agreement, would not have arisen; but their agreement prescribes the substance of the legal relations into which they have freely chosen to enter.
50 In short there is, in my judgment, no realistic prospect of Wockhardt establishing that the Early Termination provisions are penal in character. I note that in the New York case of Drexel Burnham Lambert Products Corporation v Midland Bank PLC 92 Civ 3098 (MP) the US District Court for the Southern District of New York held, on a motion for summary judgement, that a "Limited Two-Way Payments Clause" contained in a Swap Agreement constituted a valid liquidated damages clause and was enforceable in accordance with its terms since it bore a reasonable relationship to the probable loss. I do not, however, base my decision on that case in any way since both the terms of the clause and the applicable law are unclear....

These cases seem to suggest that courts in England are prepared to review the details of commercial contracts to determine whether or not provisions for payment in certain circumstances constitute penalties (the penalties argument here is not dismissed out of hand but seems to be considered seriously). Do you think that this is appropriate? This last case arose in the context of a standard form document developed by ISDA and used in numerous financial transactions. Do you think that a commonly used form of document should be treated with greater care (on the grounds of legal certainty) by a judge than a less commonly used form? Does/should it make a difference to a judge in one jurisdiction that a contractual term in a standard form document used around the world is treated as valid in other jurisdictions? Do you think it would be useful to be able to develop a system for evaluating the legal effectiveness of such documents in advance?

The risk that a contract will not be enforced by courts in the way that parties to the contract intend is an aspect of legal risk (which also includes the risk that statutes and regulations may be interpreted in surprising ways). Legal risk also includes risks associated with changes in circumstances, such as bankruptcy, as bankruptcy laws

change the legal rights of parties to contracts.

The following case arises out of a US freeze on payments to Libya. It illustrates some of the uncertainties which may impact international financial transactions and which banks have to be aware of and plan for. It also examines choice of law issues in the context of the eurodollar, and allows us to think about some payment systems issues. What does Staughton say was the proper law ? Do you agree with him? Do you agree with his reactions to the testimony of the expert witnesses?

Libyan Arab Foreign Bank v Bankers Trust (Staughton J)[20]

The plaintiffs are a Libyan corporation, wholly owned by the Central Bank of Libya. They carry on what is described as an offshore banking business, in the sense that they do not engage in domestic banking within Libya. I shall call them "the Libyan Bank." The defendants are a New York corporation with their head office there. They no doubt have a number of branches in various parts of the world; but I am concerned with one in particular, their branch in London. I shall refer to them as "Bankers Trust," and when it is necessary to refer to particular offices as "Bankers Trust London" or "Bankers Trust New York."

In January 1986 the Libyan Bank had an account with Bankers Trust London, denominated in United States dollars. That was a call account, which meant that no cheque book was provided, interest was payable on the balance standing to the credit of the account at rates which varied from time to time, and some minimal period of notice might be required before instructions relating to the account had to be complied with. The suggestion in this case is that instructions would have to be given before noon if they were to be carried out that day. In English practice it would, I think be described as a species of deposit account. The amount standing to the credit of that account at the close of business on 8 January 1986 was U.S.$131,506,389.93. There may be a small element of subsequent adjustment in that figure. But the point is not material.

The Libyan Bank also had an account with Bankers Trust New York, again denominated in United States dollars. This was a demand account. No interest was paid on the balance, and no significant period of notice was required before instructions had to be complied with. But there was not, so far as I am aware, a cheque book. In England it would have been a current account. The amount standing to the credit of that account at the close of business on 8 January 1986 was U.S.$251,129,084.53.

Relations between Libya and the United States in January 1986 were not good. At 8.06 p.m. New York time on 7 January the President of the United States of America issued an

[20] [1989] Q B 728

executive order, which had the force of law with immediate effect. It provided, so far as material:

"Section 1. The following are prohibited, except to the extent provided in regulations which may hereafter be issued pursuant to this Order: ... (f) The grant or extension of credits or loans by any United States person to the Government of Libya, its instrumentalities and controlled entities."

That order did not in itself have any great effect on the events with which this case is concerned. But there followed it at 4.10 p.m. New York time on 8 January a second order, reading as follows:

"I, Ronald Reagan, President of the United States, hereby order blocked all property and interests in property of the Government of Libya, its agencies, instrumentalities and controlled entities and the Central Bank of Libya that are in the United States that hereafter come within the United States or that are or hereafter come within the possession or control of U.S. persons including overseas branches of U.S. persons. The Secretary of the Treasury, in consultation with the Secretary of State, is authorized to employ all powers granted to me by the International Emergency Economic Powers Act 50 U.S.C. 1701 et seq. to carry out the provisions of this Order. This Order is effective immediately and shall be transmitted to the Congress and published in the Federal Register.

Ronald Reagan

The White House

8 January 1986"

It is not in dispute that Bankers Trust are a United States person; or that Bankers Trust London are an overseas branch of a United States person; or that the Libyan Bank are an agency, instrumentality or controlled entity of the Government of Libya. Consequently by the law of and prevailing in the State of New York (which I shall refer to as New York law for the sake of brevity) it was illegal at and after 4.10 p.m. on 8 January 1986 for Bankers Trust to make any payment or transfer of funds to or to the order of the Libyan Bank in New York, either by way of debit to the Libyan Bank's account or as the grant of credit or a loan. Similarly it was illegal, by the law of New York or of any other American state, for Bankers Trust to make any such payment or transfer of funds in London or anywhere else.

The United Kingdom Parliament did not enact any similar legislation. No doubt there were reasons of high policy for that forbearance; but with them I am not concerned. It is sufficient to say that nothing in English domestic law prohibited such a transaction. So the main issues in this case are concerned with the rules of conflict of laws, which determine when and to what extent the law of New York is given effect in our courts, and with the contractual obligations of banks. In a word, Bankers Trust say that they cannot, or at any rate are not obliged to, transfer a sum as large as U.S.$100m. or more without using the payment machinery that is available in New York; consequently they have a defence to the Libyan

Bank's claim, because performance of this contract would have required them to commit an illegal act in New York. Alternatively they say that their contract with the Libyan Bank is governed by the law of New York, so that performance is for the time being illegal by the proper law of the contract.

The Libyan Bank's claims

These are as follows (using a slightly different system of numbering from that adopted in the pleadings and in argument):

(1) The first claim is for the balance of U.S.$131,506,389.93 standing to the credit of the London account at the close of business on 8 January 1986. It is said that this sum is due to the Libyan Bank, and can be claimed on a cause of action in debt. Alternatively it is said that Bankers Trust ought to have responded to demands for U.S.$131m. that were made by the Libyan Bank in various different ways after 8 January, and are liable in damages.

(2) If they are right on the first claim, the Libyan Bank further say that one or other of three sums ought to have been transferred from the New York account to the London account on 7 and 8 January, thus increasing the amount which they are entitled to recover. These are: (i) U.S.$165,200,000 on 7 January, or (ii) U.S.$6,700,000 on 8 January, or (iii) U.S.$161,400,000 on 8 January. Indeed it is said that the sum of U.S.$6,700,000 was in fact transferred to London on 8 January, with the consequence that the Libyan Bank are in any event entitled to recover that additional amount.

(3) Largely but not entirely as an alternative to the second claim, the Libyan Bank say that they gave a number of payment instructions to Bankers Trust New York for execution on 8 January; those instructions could and should have been executed before 4.10 p.m. on that day, but were not. Consequently the Libyan Bank claim damages in the sum of U.S.$226,147,213.88.

(4) It is said that Bankers Trust, in breach of a duty of confidence which they owed to the Libyan Bank, disclosed information to the Federal Reserve Bank of New York on 7 or 8 January, and thereby caused damage to the Libyan Bank.

(5) Alternatively the Libyan Bank say that their contract with Bankers Trust has been frustrated, with the consequence that the Libyan Bank are entitled to the sums claimed under (1) and (2) above by virtue of the Law Reform (Frustrated Contracts) Act 1943 or as a restitutionary remedy at common law.

(6) Lastly there is a claim which is quite independent of the events of 7 and 8 January 1986 and President Reagan's executive orders. It is said that during the period from April 1984 to November 1985 Bankers Trust operated a system of transfers between the New York account and the London account, which was not in accordance with their contract with the Libyan Bank. In consequence the Libyan Bank were deprived of interest for one day or three days on a succession of sums during that period. It is said that the loss suffered is of the order of $2m. Bankers Trust do not deny that, initially, the system of transfers which they operated during this period failed to accord with their contract. But they say that, by the doctrine of account stated or

estoppel, the Libyan Bank are precluded from asserting this claim.
The issues thus raised, or at any rate those that arise under paragraph (1) above, are of great interest and some difficulty. Similar problems occurred a few years ago in connection with the freeze on Iranian assets by executive order of 14 November 1979, and litigation was commenced. But before any of those actions could come to trial the freeze was lifted. This time the problems have to be resolved.

History of the banking relationship
This can be considered in three stages. The first stage was from 1972 to 15 December 1980.

The Libyan Bank came into existence in June 1972. A correspondent relationship was established between the Libyan Bank and Bankers Trust. Initially an account was opened for that purpose with the Paris branch of Bankers Trust. But in April 1973 that account was closed, and an account opened with the London branch. It was described as a 7-day notice account. However, any requirement that notice of that length should be given before debits were allowed on the London account was not enforced. In this period the Libyan Bank did not wish to have any account with Bankers Trust New York. Transfers for the credit of the Libyan Bank used regularly to arrive at Bankers Trust New York, in accordance with the system most often used for transferring large dollar amounts, which I shall describe later. But they were dealt with by an instruction from Bankers Trust New York to Bankers Trust London to credit the account of the Libyan Bank there. Indeed the Libyan Bank insisted on that from time to time. Thus on 14 July 1973 they said in a telex to New York: "We also request immediate transfer of any funds you may receive in future for our favour to your London office." And on 17 July 1973 to London: "When we have agreed to have the account of Libyan Arab Foreign Bank with Bankers Trust I have made it very clear that no balance at all should be kept in New York and should be transferred immediately to our call account which started in Paris and now with you in London."

Certainly one motive for that attitude, and in 1973 possibly the only motive, was that dollar credit balances outside the United States earned a higher rate of interest than was obtainable in the United States. That is all that Eurodollars are - a credit in dollars outside the United States, whether in Europe or elsewhere. (It may be that one should add to this definition "at a bank" or "at an institution.") The interest rate is higher owing to the terms of the requirement imposed by the Federal Reserve Board that banks should maintain an amount equal to a proportion of the deposits they receive on deposit interest-free with the Federal Reserve system. That requirement is less demanding in connection with deposits received by overseas branches.

In fact Bankers Trust New York had operated an account in New York, for the handling of transactions by the Libyan Bank. But that account was closed on 17 December 1973 in consequence of the above and other protests by the Libyan Bank.

There followed a long period of discussion and negotiation. Bankers Trust were dissatisfied because the London, so-called 7-days' notice, account was used as a current

account. Large numbers of transactions occurred on it, but interest was paid on the balance. This was not thought to be profitable for Bankers Trust. Furthermore, transfers to or from the account would commonly be made through New York, with a risk of delay and the possibility of error. On 23 November 1977 Mr. Ronai of Bankers Trust New York wrote to the Libyan Bank as follows:

"... I am writing to outline our proposal for clearing up the operational difficulties encountered in your dollar-clearing activity through Bankers Trust in New York.

"I feel that the problems stem from the number of intermediate steps required to effect a large number of transfers to and from your London Call account via New York. In order to simplify this situation, my proposal is to set up a fully-managed account relationship with Libyan Arab Foreign Bank. This should provide you with several major benefits, among which are:

- more timely information for yourselves
- simplification of transactions
- greater ease in researching possible errors
- the ability to tailor the system to your requirements.

"The basic elements of a managed account consist of a current account in New York and a call account in London with Bankers Trust Co. The current account will be used for your daily dollar-clearing activity; the call account should be considered as an investment of liquid funds. An explanation of the operation of your managed account follows.

"On a daily basis, all transactions concerning the demand account are reviewed, and the balance is 'managed' so that it does not exceed or fall below a predetermined target or 'peg' balance. Excess funds will be credited to your call account, or your current account will be funded from your call account, as the case may be."

In 1980 that proposal was more actively pursued. At first it was suggested by Bankers Trust that the current account should be in London. But by the time of a meeting in New York on 7 July it was again proposed that there should be a demand account there. Following that meeting Bankers Trust wrote from London to the Libyan Bank with details of the proposed managed account system:

"We will establish a 'peg' (or target) balance for the demand account of U.S.$750,000. That amount is intended to compensate Bankers Trust Co. for the services which we expect to provide, and is subject to periodic renegotiation as appropriate, for example when our costs increase, when interest rates decline significantly or when our level of servicing is materially changed. Each morning our account management team will review the demand account's closing book balance from the previous business day. If that balance is in excess of the 'peg,' they will transfer in multiples of U.S.$100,000 the excess amount to your call account in London with value the previous business day.

"Similarly, if the demand account balance is below the U.S.$750,000 peg, they will transfer funds back from your call account with value the previous business day. ... As you can appreciate, our account management team must closely follow the balance in your call account.

Given time zone differences with London, all entries to your call account must be passed by that team in New York, and all your instructions to effect payments or foreign exchange settlements must be directed to our money transfer department in New York."

The figure of U.S.$750,000 as the peg balance was later agreed at U.S.$500,000.

There was some discussion of political risk at the New York meeting. I am confident that political risk was at any rate in the minds of both parties, seeing that the freeze on Iranian assets had occurred only eight months previously. Mr. Abduljawad, then deputy chairman, is recorded as saying: "Placing at call is not an effort to avoid political risk, which he believes to be unavoidable." Whilst I accept that record as accurate, I also accept Mr. Abduljawad's oral evidence that "political risk is always being taken into consideration." Mr. Van Voorhees, who was among those attending the meeting on behalf of Bankers Trust, accepted that the Iranian crisis was at the back of everyone's mind in 1980.

A further meeting took place in Paris on 28 October 1980 between Mr. Abduljawad and Mr. Van Voorhees. At that meeting too no complete agreement was reached, so there was no new agreement or variation of the existing agreement. But important progress was made. Mr. Van Voorhees explained in plain terms that all the Libyan Bank's transactions would have to pass through New York. According to Mr. Van Voorhees, Mr. Abduljawad at first objected to that requirement, but later agreed to it. Mr. Abduljawad's evidence was that he did not reject it and equally did not agree to it. I do not need to resolve that conflict. It is plain to me that one of the terms which Bankers Trust were putting forward for the new arrangement was that all transactions should pass through New York; whether or not it was accepted at that stage is immaterial.

There followed a meeting in Tripoli and correspondence between the parties, and agreement was finally reached by 11 December 1980. Thus the managed account system was agreed on. Bankers Trust New York would open a demand account for the Libyan Bank, with a peg balance of U.S.$500,000. Transfers between that account and the call account in London would be made, as the need arose, in multiples of U.S.$100,000. The need for a transfer would be determined each morning by examining the closing balance of the New York account for the previous business day; if appropriate a transfer to or from London would be made with value the previous business day - in other words, it would take effect from that date for interest purposes.

It was, as I find, a term of that arrangement that all the Libyan Bank's transactions should pass through New York. Although not mentioned in the correspondence by which agreement was ultimately reached, this had plainly been a requirement of Bankers Trust throughout the later stages of the negotiations, and I conclude that it was tacitly accepted by the Libyan Bank. It was virtually an essential feature of the system: Bankers Trust New York would know about and rely on the credit balance in London in deciding what payments could be made from New York; they might be exposed to risk if the balance in London could be reduced without their knowledge. It was argued that such a term is not to be found in the pleadings of

Bankers Trust; but in my judgment it is, in paragraph 3(4)(v) of the re-re-amended points of defence. There remains an important question whether the managed account arrangement was irrevocable, or whether it could be determined. I shall consider that later.

The second stage ran from December 1980 to November 1985. Before very long Bankers Trust took the view that the remuneration which they received from the relationship, in the form of an interest-free balance of between U.S.$500,000 and U.S.$599,999 in New York, was insufficient reward for their services. On 15 March 1983 they proposed an increase in the peg balance to $1.5m. Negotiations continued for a time but without success. By 15 March 1984 Bankers Trust had formed the view that the Libyan Bank would not agree to an increase in the peg balance; so, on 3 April 1984, they decided unilaterally on a different method of increasing the profitability of the relationship for Bankers Trust; and it was put into effect on 17 April.

The new method required a consideration of the balance on the New York account at 2 p.m. each day. If it exceeded the peg balance of U.S.$500,000 the excess was transferred in multiples of U.S.$100,000 to the London account with value that day. Consideration was also given on the following morning to the balance at the close of the previous day. If it was less than the peg balance, a transfer of the appropriate amount was made from London to New York on the next day, with value the previous business day; if it was more than the peg balance there was, it seems, a transfer to London with value the same day. The effect of the change was that the Libyan Bank lost one day's interest whenever (i) credits received after 2 p.m. exceeded payments made after 2 p.m., and (ii) the closing balance for the day would under the existing arrangement have required a transfer (or a further transfer if one had been made at 2 p.m.) to be made with value that day. If a weekend intervened, three days interest might be lost. I am not altogether sure that I have stated the effect of the change correctly; but precision as to the details is not essential.

Bankers Trust did not tell the Libyan Bank about this change. Indeed an internal memorandum of Bankers Trust dated 14 August 1984 wondered whether Libya (possibly referring to the Libyan Bank) would notice the drop in interest earnings. Although the effect was on any view substantial, I am satisfied that the Libyan Bank did not in fact appreciate what was happening until mid-1985; and they complained about it to Bankers Trust in October 1985. I am also satisfied that the Libyan Bank could have detected, if they had looked at their statements from Bankers Trust with a fair degree of diligence, that they were not receiving the full benefit by way of interest to which they were entitled. Indeed, they did, as I have said, eventually detect that. But I am not convinced - if it matters - that they could have divined precisely what system Bankers Trust were now operating.

The third stage began on 27 November 1985, with a telex from Bankers Trust which recorded the agreement of the Libyan Bank to a new arrangement. This telex is important, and I must set out part of it:

"As discussed with you during our last meeting in your office in Tripoli, we have changed the

method of investment from same day by means of next day back valuation, to actual same day with investment cut off time of 2 p.m. New York time. ... In this regard, those credits which are received after our 2 p.m. New York time cut off which result in excess balances are invested with next day value. This you will see from observing your account. For your information, the way our same day investment system works, is as follows: each day, at 2 p.m. the balance position of your account is determined and any credits received up to that time, less payments and less the peg balance, are immediately invested. An example of this investment system can be seen for instance by comparing both statements of your demand and call accounts for 26 and 30 September 1985 which indicate same day investment on 26 September for U.S.$33.7 million which is reflected on your London call account statement on 27 September with value 26 September and on 30 September for U.S.$181.3 million which is reflected on your London call account statement on 1 October with value 30 September."

That was not in substance any different from the system which Bankers Trust had been operating since April 1984 without informing the Libyan Bank. It was now accepted by them.

7 and 8 January 1986

At 2 p.m. on 7 January the balance to the credit of the New York account was U.S. $165,728,000. (For present purposes I use figures rounded down to the nearest U.S.$1,000, save where greater accuracy is desirable.) Subject to two points which I shall consider later, a transfer of $165.2m. should then have been made to London. Mr. Fabien Arnell, an account manager of Bankers Trust New York, says somewhat laconically in his statement:

"On 7 January 1986 I instructed the managed account clerk not to make a 2 p.m. investment. I cannot now recall the precise reason why I gave that instruction."

During the rest of that day there were substantial transfers out of the New York account, with the result that it would have been overdrawn to the extent of $157,925,000 if the 2 p.m. transfer had been made. There would then have had to be a recall of U.S.$158,500,000 from London on 8 January, with value the previous business day, to restore the peg balance. As no 2 p.m. transfer had been made, the closing balance was in fact U.S.$7,275,000 in credit.

On the morning of 8 January there was an amount of $6,700,000 available to transfer to London. The same amount would have been left as a net credit to the London account if $165.2m. had been transferred at 2 p.m. on 7 January and $158.5m. recalled on 8 January with value the previous day. An instruction for the transfer of U.S.$6,700,000 was prepared. But in the event the computer which kept the accounts in New York was not ordered to effect this transfer, nor was the London branch informed of it.

At 2 p.m. on 8 January the balance to the credit of the New York account was U.S.$161,997,000. After deducting the peg balance of U.S.$500,000 there was a sum of U.S.$161,400,000 available to transfer to London. No transfer was made. Those figures assume, as was the fact, that U.S.$6,700,000 had not been transferred to London in respect of the excess opening balance on that day.

Bankers Trust New York had received payment instructions totalling U.S. $347,147,213.03 for execution on 8 January. All of them had been received by 8.44 a.m. New York time. None of them were executed, for reasons which I shall later explain. (In case it is thought that not even the combined London and New York accounts could have sustained such payments, I should mention that substantial credits were received in New York during 8 January for the account of the Libyan Bank. If all the payment instructions had been implemented, there would still at the end of the day have been a net balance due to the Libyan Bank on the total of the two accounts)....

Next I turn to the Civil Evidence Act statement of Mr. Brittain, the chairman of Bankers Trust. Late in the afternoon of 7 January he received a telephone call from Mr. Corrigan, the president of the Federal Reserve Bank of New York. Mr. Corrigan asked that Bankers Trust should pay particular attention on the next day to movement of funds on the various Libyan accounts held by Bankers Trust, and report anything unusual to him.

Late in the morning of the next day Mr. Brittain informed the New York Fed. (as it is sometimes called) that "it looked like the Libyans were taking their money out of the various accounts." (So far as the Libyan Bank were concerned, it will be remembered that they had already given instructions for payments totalling over U.S.$347m. on that day.) Later Mr. Brittain learnt that sufficient funds were coming in to cover the payment instructions; he telephoned Mr. Corrigan and told him that the earlier report had been a false alarm. Mr. Corrigan asked Mr. Brittain not to make any payments out of the accounts for the time being, and said that he would revert later.

That assurance was repeated several times during the early afternoon. Mr. Brittain's statement continues:

"Finally I telephoned Mr. Corrigan at about 3.30 p.m. and told him that we now had sufficient funds to cover the payments out of the various Libyan accounts and were going to make them. Mr. Corrigan's response to this was, 'You'd better call Baker' (by which he meant the Secretary of the United States Treasury, Mr. James A. Baker III). I said that I would release the payments and then speak to Mr. Baker. Mr. Corrigan's reply to this was. 'You'd better call Baker first'."

Mr. Brittain was delayed for some 20 minutes talking to Mr. Baker and to an assistant secretary of the Treasury on the telephone. Then at approximately 4.10 to 4.15 p.m. Mr. Baker said: "The President has signed the order, you can't make the transfers."

Mr. Brittain adds in his statement that this was the first occasion on which he became aware that an order freezing the assets was contemplated. In a note made a few weeks after 8 January he adds: "That is how naive I was." I am afraid that I can but agree with Mr. Brittain's description of himself. It seems to me that a reasonable banker on the afternoon of 8 January would have realised, in the light of the first executive order made on the previous day, the requests of Mr. Corrigan, and particularly his saying "You'd better call Baker first," that a ban on payments was a distinct possibility.

There is other evidence as to Mr. Brittain's telephone conversations. First, Mr. Blenk

was in Mr. Brittain's office and heard what was said by him. There was not, it seems, any reference by name to Libyan Arab Foreign Bank, but merely to "the Libyans," which meant some six Libyan entities (including the Libyan Bank) which had accounts with Bankers Trust. Secondly, Mr. Sandberg, a senior vice-president of the Federal Reserve Bank of New York, heard Mr. Corrigan's end of the conversations. He accepted in evidence that the New York Fed. probably knew which Libyan banks held accounts with Bankers Trust.

The Federal Reserve Board Regulations

Considerable emphasis was placed on these Regulations. But in my judgment they are not determinative of anything in this case.

Regulation D imposes a reserve requirement equal to 12 per cent. of the amount of deposits held by banks in the United States. The reserve must be held either in the form of vault cash or as an interest-free deposit with a Federal Reserve Bank. Regulation D accordingly imposes a constraint on the rate of interest which a bank in the United States can offer to depositors. But by section 204 (c)(5) it does not apply "to any deposit that is payable only at an office located outside the United States." That is further defined in section 204.2(t) as a deposit as to which the depositor is entitled "to demand payment only outside the United States." Bankers Trust did not include the Libyan Bank's London account in the deposits for which they maintained a reserve of 12 per cent. in accordance with Regulation D.

There are three possible conclusions which I might draw from that evidence. They are (i) that the sum standing to the credit of the London account was payable only at an office located outside the United States; or (ii) that section 204(c)(5) bears some other meaning than that which it appears to have in plain English; or (iii) that Bankers Trust casually disregarded Regulation D. I have already rejected the first solution, and have found on the evidence of Mr. Van Voorhees and the documents that after December 1980 all operations on the London account were, by express agreement, to be conducted through New York. Consideration of Regulation D and what Bankers Trust did about it does not cause me to have any doubt on that point.

It follows that either section 204(c)(5) does not mean what it appears to say, or else Bankers Trust disregarded it. I do not need to decide which of those alternatives is correct for the purposes of this case. But it does seem in fact that section 204(c)(5) has a somewhat surprising meaning. That appears from the Memorandum of Law of the Federal Reserve Bank of New York ..as amicus curiae in Wells Fargo Asia Ltd. v. Citibank N.A. (1985) 612 F.Supp. 351:

"The location where the depositor has legal right to demand payment is a distinct concept from the location where the deposit is settled. The fact that settlement of United States dollar deposit liabilities takes place in the United States between United States domiciliaries is not determinative of where the deposit is legally payable. Virtually all United States larger-dollar transactions between parties located outside the United States must be settled in the United

States. The Clearing House Interbank Payments System or C.H.I.P.S., operated by the New York Clearing House Association for some 140 banks, handles at least U.S.$400 billion in transfers each day, and it is assumed that perhaps 90 per cent. of these payments are in settlement of offshore transactions. If that fact alone were relevant to where a deposit is legally payable, the exemption in Regulation D would almost never apply to foreign-branch deposits denominated in United States dollars. Clearly, the exemption is not limited to deposits denominated in a foreign currency and is available to foreign branches of United States banks that book deposits denominated in United States dollars."

If there were not some such interpretation the whole Eurodollar market might well be thrown into disarray, or even disappear altogether. In many if not most cases it would be impossible for banks outside the United States to offer the higher interest rates which are a feature of that market.

Whether that doctrine would apply in a case such as the present, where there was an express term that all operations in the London account should be conducted through New York, is something which I need not decide. It would seem to be a generous interpretation which equates that to "payable only at an office located outside the United States." But it does not affect the result in this case.

Nor do I need to mention Regulation Q, F.D.I.C. Insurance or the 3 per cent. reserve requirement for a bank's Euro-currency liabilities.

The demands made

On 28 April 1986 the Libyan Bank sent a telex to Bankers Trust London in these terms: "We hereby instruct you to pay to us at 10.30 a.m. U.K. time on Thursday 1 May 1986 out of our U.S. dollar account number 025-13828 at Bankers Trust London the sum of U.S. dollars one hundred and thirty one million. We make demand accordingly. This sum is to be paid to us in London at the said time and date either by a negotiable banker's draft in such amount (U.S.$131,000,000.00) drawn on Bankers Trust London payable in London to ourselves (Libyan Arab Foreign Bank) or to our order. Alternatively we will accept payment in cash although we would prefer to be provided with a banker's draft as aforesaid."

On the same day a demand in similar terms was made for oe161m., on the basis that this amount should have been transferred from the New York account to the London account at 2 p.m. on 8 January 1986.

Neither demand was complied with. Bankers Trust replied that it would be unlawful (sc. by New York or any other United States law) for them to pay in London. That was factually correct. The question is whether it was relevant. Bankers Trust also denied that the U.S.$161m. transfer should have been made on 8 January.

The action 1986 L. No. 1567 was then started by the Libyan Bank against Bankers Trust. In correspondence between the parties' solicitors various other methods of payment were discussed. In addition the Libyan Bank's solicitors by letter dated 30 July 1986 said that, in so

far as notice was required to terminate the managed account arrangement, (1) notice had been given by the Libyan Bank's telex of 28 April 1986 or (2) notice was then given by the solicitors in their letter.

Finally, there was a further demand made in a telex from the Libyan Bank to Bankers Trust on 23 December 1986:

"We now hereby further demand that you pay to us within seven days from receipt of this telex in London, England, the said sums of U.S.$131,000,000 - and U.S.$161,000,000 - respectively, either by the means set out in our April demands or by any other commercially recognised method of transferring funds, which will result in our receiving unconditional payment in London within the said seven-day period.

"In particular (but without prejudice to the foregoing) the said sums of U.S.$131,000,000 - and U.S.$161,000,000 - (or either of them) may be transferred in compliance with these demands by any such commercially recognised method to the U.B.A.F. Bank Ltd. London for the credit of our dollar account number 0000104-416. We reiterate, however that our demands are for us to receive unconditional payment in London within the said seven-day period. If therefore, a transfer or clearing procedure is employed by you to comply with our demands, such procedure must be such that funds or credits said to represent any part of the debt which you owe to us in London are not, in the result, frozen or otherwise impeded in the United States. We would not object to your exercising your right to pay us in sterling, and, if so, our sterling account number at the above bank is 0000103-919."....

(1) The U.S.$131 million claim

(a) Conflict of laws - the connecting factor

There is no dispute as to the general principles involved. Performance of a contract is excused if (i) it has become illegal by the proper law of the contract, or (ii) it necessarily involves doing an act which is unlawful by the law of the place where the act has to be done. I need cite no authority for that proposition (least of all my own decision in Euro-Diam Ltd. v. Bathurst [1987] 2 W.L.R. 1368, 1385) since it is well established and was not challenged. Equally it was not suggested that New York law is relevant because it is the national law of Bankers Trust, or because payment in London would expose Bankers Trust to sanctions under the United States legislation, save that Mr. Sumption for Bankers Trust desires to keep the point open in case this dispute reaches the House of Lords.

There may, however, be a difficulty in ascertaining when performance of the contract "necessarily involves" doing an illegal act in another country. In Toprak Mahsulleri Ofisi v. Finagrain Compagnie Commerciale Agricole et Financiere S.A. [1979] 2 Lloyd's Rep. 98, Turkish buyers of wheat undertook to open a letter of credit "with and confirmed by a first class United States or West European bank." The buyers were unable to obtain exchange control permission from the Turkish Ministry of Finance to open a letter of credit, and maintained that it was impossible for them to open a letter of credit without exporting money from Turkey. It was

held that this was no answer to a claim for damages for nonperformance of the contract. Lord Denning M.R. said, at p. 114:

"In this particular case the place of performance was not Turkey. Illegality by the law of Turkey is no answer whatever to this claim. The letter of credit had to be a confirmed letter of credit, confirmed by a first-class West European or U.S. bank. The sellers were not concerned with the machinery by which the Turkish state enterprise provided that letter of credit at all. The place of performance was not Turkey.

"This case is really governed by the later case of Kleinwort, Sons & Co. v. Ungarische Baumwolle Industrie Aktiengesellschaft [1939] 2 K.B. 678 where bills of exchange were to be given and cover was to be provided in London, but at the same time there was a letter saying, 'We have to get permission from Hungary.' It was said that because of the illegality by Hungarian law in obtaining it, that would be an answer to the case. But Branson J. and the Court of Appeal held that the proper law of the contract was English law; and, since the contract was to be performed in England, it was enforceable in the English courts even though its performance might involve a breach by the defendants of the law of Hungary.

"That case has been quoted in all the authorities as now settling the law. ... The only way that Mr. Johnson (for the Turkish state enterprise) could seek to escape from that principle was by saying - '... Although there was no term, express or implied, in the contract that anything had to be done in Turkey as a term of the contract, nevertheless it was contemplated by both parties. It was contemplated by both parties that the Turkish buyers would have to go through the whole sequence in Turkey of getting exchange control permission, and all other like things: and, if the contemplated method of performance became illegal, that would be an answer. Equally, if it became impossible, that would be a frustration.'

"I am afraid that those arguments do not carry the day. It seems to me in this contract, where the letter of credit had to be a confirmed letter of credit - confirmed by a West European or U.S. bank - the sellers are not in the least concerned as to the method by which the Turkish buyers are to provide that letter of credit. Any troubles or difficulties in Turkey are extraneous to the matter and do not afford any defence to an English contract ..."

From that case I conclude that it is immaterial whether one party has to equip himself for performance by an illegal act in another country. What matters is whether performance itself necessarily involves such an act. The Turkish buyers might have had money anywhere in the world which they could use to open a letter of credit with a United States or West European bank. In fact it would seem that they only had money in Turkey, or at any rate needed to comply with Turkish exchange control regulations if they were to use any money they may have had outsideTurkey. But that was no defence, as money or a permit was only needed to equip themselves for performance, and not for performance itself.

Mr. Sumption took the same route as Mr. Johnson did in the Toprak case. He argued that the court could look at the method of performance which the parties had contemplated, and relied on Regazzoni v. K.C. Sethia (1944) Ltd. [1958] A.C. 301. (Mercifully he refrained from

citing Foster v. Driscoll [1929] 1 K.B. 470.) In Regazzoni's case the plaintiff had agreed to buy 500,000 jute bags from the defendants c.i.f. Genoa. It was, of course, open to the defendants as a matter of law to ship the goods to Genoa from anywhere in the world. But in practice the goods had to be obtained from India, both parties knew that this was intended and they also knew that the plaintiff intended to re-export the goods to South Africa. It was illegal by Indian law, again as both parties knew, to export goods from India destined to South Africa directly or indirectly. The plaintiff's claim failed.

I am relieved from the task of distinguishing between the Toprak principle and Regazzoni's case by a most helpful analysis of Robert Goff J. in the Toprak case itself at first instance which I gratefully adopt. He there held [1979] 2 Lloyd's Rep. 98, 107 that there were two related but distinct principles. The principle of Regazzoni's case was derived from the judgment of Sankey L.J. in Foster v. Driscoll, at pp. 521-522:

"An English contract should and will be held invalid on account of illegality if the real object and intention of the parties necessitates them joining in an endeavour to perform in a foreign and friendly country some act which is illegal by the law of such country notwithstanding that there may be, in a certain event, alternative modes or places of performing which permit the contract to be performed legally."

Even if that principle can be applied to supervening illegality as opposed to illegality ab initio (a point which I would regard as open to question), it does not apply in this case. At no stage was it the real object and intention of the Libyan Bank that any illegal act should be performed in New York. That was not suggested in argument or in the course of the evidence. This case accordingly raises only the other principle, that performance is excused if it necessarily involves doing an act which is unlawful by the law of the place where the act has to be done.

Some difficulty may still be encountered in the application of that principle. For example, if payment in dollar bills in London was required by the contract, it would very probably have been necessary for Bankers Trust to obtain such a large quantity from the Federal Reserve Bank of New York, and ship it to England. That, Mr. Sumption accepts, would not have been an act which performance necessarily involved; it would merely have been an act by Bankers Trust to equip themselves for performance, as in the Toprak case. By contrast, if the contract required Bankers Trust to hand over a banker's draft to the Libyan Bank in London, Mr. Sumption argues that an illegal act in New York would necessarily be involved, since it is very likely that the obligation represented by the draft would ultimately be honoured in New York. I must return to this problem later.

(b) The proper law of the contract

As a general rule the contract between a bank and its customer is governed by the law of the place where the account is kept, in the absence of agreement to the contrary. Again there was no challenge to that as a general rule; the fact that no appellate decision was cited to

support it may mean that it is generally accepted....

That rule accords with the principle, to be found in the judgment of Atkin L.J. in N. Joachimson v. Swiss Bank Corporation [1921] 3 K.B. 110, 127, and other authorities, that a bank's promise to repay is to repay at the branch of the bank where the account is kept.

In the age of the computer it may not be strictly accurate to speak of the branch where the account is kept. Banks no longer have books in which they write entries; they have terminals by which they give instructions; and the computer itself with its magnetic tape, floppy disc or some other device may be physically located elsewhere. Nevertheless it should not be difficult to decide where an account is kept for this purpose, and it is not in the present case. The actual entries on the London account were, as I understand it, made in London, albeit on instructions from New York after December 1980. At all events I have no doubt that the London account was at all material times "kept" in London.

Mr. Sumption was prepared to accept that the proper law governing the London account was English law from 1973 to December 1980. But he submitted that a fundamental change then took place, when the managed account arrangement was made. I agree that this was an important change, and demands reconsideration of the proper law from that date. That the proper law of a contract may be altered appears from Whitworth Street Estates (Manchester) Ltd. v. James Miller & Partners Ltd. [1970] A.C. 583, per Lord Reid at p. 603, and per Lord Wilberforce at p. 615.

Mr. Cresswell for the Libyan Bank submits that there then arose two separate contracts, of which one related to the London account and remained governed by English law; alternatively he says that there was one contract, again governed by English law; or that it had two proper laws, one English law and the other the law of New York. Mr. Sumption submits that there was from December 1980 one contract only, governed by New York law.

Each side has relied on a number of points in support of its contentions. I do not set them out, for they are fairly evenly balanced, and in my view do little or nothing to diminish the importance of the general rule, that the proper law of a bank's contract is the law of the place where the account is kept. Political risk must commonly be an important factor to those who deposit large sums of money with banks; the popularity of Swiss bank accounts with some people is due to the banking laws of the Cantons of Switzerland. And I have already found, on the evidence of Bankers Trust, that the Iranian crisis was at the back of everyone's mind in 1980. Whatever considerations did or did not influence the parties to this case, I believe that banks generally and their customers normally intend the local law to apply. So I would require solid grounds for holding that the general rule does not apply, and there do not appear to me to be such grounds in this case.

I have, then, to choose between the first and third of Mr. Cresswell's arguments - two separate contracts or one contract with two proper laws. It would be unfortunate if the result of this case depended on the seemingly unimportant point whether there was one contract or two. But if it matters, I find the notion of two separate contracts artificial and unattractive. The device

of a collateral contract has from time to time been adopted in the law, generally to overcome some formal requirement such as the ci-devant parole evidence rule, or perhaps to avoid the payment of purchase tax, and at times for other purposes. No doubt it has achieved justice, but at some cost to logic and consistency. In my judgment, the true view is that after December 1980 there was one contract, governed in part by the law of England and in part by the law of New York. It is possible, although unusual, for a contract to have a split proper law, as Mr. Sumption accepted: see Dicey & Morris The Conflict of Laws, 11th ed. (1987), p. 1163 and Chitty on Contracts, 25th ed. (1983), para. 2081. Article 4 of the E.E.C. Convention of 19 June 1980 on the Law Applicable to Contractual Obligations (Official Journal 1980 No. L.266, p. 1) (as I write not yet in force) provides:

"1. To the extent that the law applicable to the contract has not been chosen in accordance with article 3, the contract shall be governed by the law of the country with which it is most closely connected. Nevertheless, a severable part of the contract which has a closer connection with another country may by way of exception be governed by the law of that other country."

That such a solution is not necessarily unacceptable to businessmen is shown by one of the Australian printed forms of charterparty, which adopts it.

Mr. Sumption argues that difficulty and uncertainty would arise if one part of the contract was governed by English law and another by New York law. I do not see that this would be so, or that any difficulty which arose would be insuperable.

There is high authority that branches of banks should be treated as separate from the head office. See for example Reg. v. Grossman (1981) 73 Cr.App.R. 302, where Lord Denning M.R. said, at p. 308:

"The branch of Barclays Bank in Douglas, Isle of Man, should be considered as a different entity separate from the head office in London."

That notion, of course, has its limits. A judgment lawfully obtained in respect of the obligation of a branch would be enforceable in England against the assets of the head office. (That may not always be the case in America.) As with the theory that the premises of a diplomatic mission do not form part of the territory of the receiving state, I would say that it is true for some purposes that a branch office of a bank is treated as a separate entity from the head office.

This reasoning would support Mr. Cresswell's argument that there were two separate contracts, in respect of the London account and the New York account. It also lends some support to the conclusion that if, as in my preferred solution, there was only one contract, it was governed in part by English law and in part by New York law. I hold that the rights and obligations of the parties in respect of the London account were governed by English law.

If I had not reached that conclusion, and if the managed account arrangement was brought to an end as suggested by the Libyan Bank's solicitors in their letter of 30 July 1986, I would have had to consider whether the London account then ceased to be governed by New York law and became governed by English law once more.

(c) The nature of a bank's obligations

It is elementary, or hornbook law to use an American expression, that the customer does not own any money in a bank. He has a personal and not a real right. Students are taught at an early stage of their studies in the law that it is incorrect to speak of "all my money in the bank." See Foley v. Hill (1848) 2 H.L.Cas. 28, 36, where Lord Cottenham said:

"Money, when paid into a bank, ceases altogether to be the money of the principal ... it is then the money of the banker, who is bound to return an equivalent by paying a similar sum to that deposited with him when he is asked for it ... The money placed in the custody of a banker is, to all intents and purposes, the money of the banker, to do with as he pleases. ..."

Naturally the bank does not retain all the money it receives as cash in its vaults; if it did, there would be no point or profit in being a banker. What the bank does is to have available a sufficient sum in cash to meet all demands that are expected to be made on any particular day.

I mention these simple points in order to clarify the real problem, which is what the obligation of a bank is. There are passages in the experts' reports which appear inconsistent with what I have said. Thus Dr. Marcia Stigum, who gave evidence for Bankers Trust, wrote: "Dollars deposited and dollars lent in wholesale Eurodollar transactions never leave the United States." That statement no doubt makes sense to an economist. For a lawyer it is meaningless.

The obligation of a bank is not, I think, a debt pure and simple, such that the customer can sue for it without warning. Thus in Richardson v. Richardson [1927] P. 228, Hill J. said, at p. 232-233:

"Certain contractual obligations of a bank and its customer, in the absence of special agreement, are well ascertained. They include these implied terms, as stated by Atkin L.J. in Joachimson v. Swiss Bank Corporation [1921] 3 K.B. 110, 127: (a) the promise of the bank to repay is to repay at the branch of the bank where the account is kept, and (b) the bank is not to be called upon to pay until payment is demanded at the branch at which the account is kept. ... If a demand is made at the branch where the account is kept and payment is refused, the position is altered. Undoubtedly the bank is then liable to be sued wherever it can be served."

That in itself is, in my judgment, an answer to one of the ways in which the Libyan Bank put their claim. They cannot sue on a cause of action in debt without more. They must allege a demand made which Bankers Trust were obliged to comply with. Or, to put the point in another way, English law currently recognises that an obligation to pay money can be frustrated: see Ralli Brothers v. Compa ia Naviera Sota y Aznar [1920] 2 K.B. 287, and contrast the view expressed by Dr. F. A. Mann in The Legal Aspect of Money, 4th ed. (1982), pp. 66, 421.

What is the customer entitled to demand? In answering that question one must, I think, distinguish between services which a bank is obliged to provide if asked, and services which many bankers habitually do, but are not bound to, provide. For a private customer with a current account I would include in the first category the delivery of cash in legal tender over the bank's counter and the honouring of cheques drawn by the customer. Other services, such as standing orders, direct debits, banker's drafts, letters of credit, automatic cash tills and foreign currency

for travel abroad, may be in the second category of services which the bank is not bound to but usually will supply on demand. I need not decide that point. The answer may depend on the circumstances of a particular case.

The problem in this case does not arise from the current account of a private customer. There was a correspondent relationship between the two banks, and a call account in London credited with very large sums denominated in United States dollars. The class of demands to which Bankers Trust were obliged to respond may be very different, and must be considered afresh.

It is not, in my judgment, right to assume that the obligation of such a bank is to make payment, and then to look at the charterparty cases in order to discover what "payment" is. In The Brimnes [1975] Q.B. 929, 948, Edmund Davies L.J. said:

"Clause 5 required payment to be made 'in New York in cash in United States currency. ...' The owners' contention, however, that the tendering of the commercial equivalent of cash would suffice found favour with Brandon J. In particular, he concluded that any transfer of funds to M.G.T. for the credit of the owners' account so as to give them the unconditional right to the immediate use of the funds transferred was good payment. In my judgment, that was clearly right. ..."

That was followed in Mardorf Peach & Co. Ltd. v. Attica Sea Carriers Corporation of Liberia [1976] Q.B. 835 (reversed on another point [1977] A.C. 850).

Those cases show, first that the word "cash" in a charterparty does not comprise only pound notes or dollar bills (for the avoidance of doubt, I should say that it has that narrower meaning in this judgment), and secondly that shipping people and banks regard some instruments as the equivalent of cash. Amongst those instruments are a banker's draft and a banker's payment.

(d) Means of transfer

The credit balance of the Libyan Bank with Bankers Trust constituted a personal right, a chose in action. At bottom there are only two means by which the fruits of that right could have been made available to the Libyan Bank. The first is by delivery of cash, whether dollar bills or any other currency, to or to the order of the Libyan Bank. The second is the procuring of an account transfer. (I leave out of account the delivery of chattels, such as gold, silver or works of art, since nobody has suggested that Bankers Trust were obliged to adopt that method. The same applies to other kinds of property, such as land.)

An account transfer means the process by which some other person or institution comes to owe money to the Libyan Bank or their nominee, and the obligation of Bankers Trust is extinguished or reduced pro tanto. "Transfer" may be a somewhat misleading word, since the original obligation is not assigned (notwithstanding dicta in one American case which speak of assignment); a new obligation by a new debtor is created.

Any account transfer must ultimately be achieved by means of two accounts held by

different beneficiaries with the same institution. In a simple case the beneficiaries can be the immediate parties to the transfer. If Bankers Trust held an account with the A bank which was in credit to the extent of at least $131m., and the Libyan Bank also held an account at the A bank, it would require only book entries to achieve an account transfer. But still no property is actually transferred. The obligation of Bankers Trust is extinguished, and the obligation of A bank to Bankers Trust extinguished or reduced; the obligation of A bank to the Libyan Bank is increased by the like amount.

On occasion a method of account transfer which is even simpler may be used. If X Ltd. also hold an account with Bankers Trust London, and the Libyan Bank desire to benefit X Ltd., they instruct Bankers Trust to transfer $131m. to the account of X Ltd. The obligation of Bankers Trust to the Libyan Bank is extinguished once they decide to comply with the instruction, and their obligation to X Ltd. is increased by the like amount. That method of account transfer featured in Momm v. Barclays Bank International Ltd. [1977] Q.B. 790.

In a complex transaction at the other end of the scale there may be more than one tier of intermediaries, ending with a Federal Reserve Bank in the United States. Thus the payer may have an account with B bank in London, which has an account with C bank in New York; the payee has an account with E bank in London, which has an account with D bank in New York. Both C bank and D bank have accounts with the Federal Reserve Bank in New York. When an account transfer is effected the obligations of the New York Fed. to C bank, of C bank to B bank, and of B bank to the payer are reduced; the obligations of the New York Fed. to D bank, of D bank to E bank, and of E bank to the payee are increased. That is, in essence, how the Clearing House Interbank Payments System (C.H.I.P.S.) works, by which a large proportion of transfers of substantial dollar amounts are made.

I shall call the three methods which I have described a correspondent bank transfer, an in-house transfer and a complex account transfer. There are variations which do not precisely fit any of the three, but the principle is the same in all cases. Sooner or later, if cash is not used, there must be an in-house transfer at an institution which holds accounts for two beneficiaries, so that the credit balance of one can be increased and that of the other reduced. In the example of a complex account transfer which I have given that institution is the New York Fed., which holds accounts for C bank and D bank.

Evidence was given by Professor Scott of a method which, at first sight, did not involve an in-house transfer at any institution. That was where different Federal Reserve Banks were used. However, the Professor assured me that an in-house transfer was involved, although it was too complicated to explain. That invitation to abstain from further inquiry was gratefully accepted.

Thus far I have been assuming that only one transaction affecting any of the parties takes place on a given day. But manifestly that is unlikely to be the case; there may be thousands, or tens of thousands. One purpose of a clearing system between banks must be to set off transfers against others, not only between the same parties but also between all other

parties to the clearing system. Thus C bank and D bank, in my example of a complex account transfer, may have made many transactions between themselves on the same day. Only the net balance of them all will be credited to one by the New York Fed. and debited to the other at the end. So the identity of the sum which the payer wished to pay to the payee may be entirely lost in one sense. The net balance may be the other way, and a sum be credited to C bank and debited to D bank instead of vice versa. Or, by a somewhat improbable coincidence, the net balance may be nil.

There are two further complications. The first is that set-off occurs not only between C bank and D bank, but between all other participants to the clearing system. An amount which would otherwise fall to be debited to C bank and credited to D bank may be reduced (i) because F bank has made transfers on that day to C bank, or (ii) because D bank has made transfers on that day to G bank.

Secondly, an intermediate clearing system may be used, such as London dollar clearing. If the chain of transmission on each side reaches a bank that is a member of the London dollar clearing, and if the item in question is eligible for that clearing system, it may be put through it. Then it will go to make up the net credit or debit balances that are due between all the members at the end of the day - and they in turn are settled in New York.

(e) Particular forms of transfer

I set out below those which have been canvassed in this case, and discuss the extent to which they involve activity in the United States.

(i) In-house transfer at Bankers Trust London

This is quite simple, as has been explained. It involves no action in the United States. But it cannot take place unless the Libyan Bank are able to nominate some beneficiary who also has an account with Bankers Trust London.

(ii) Correspondent bank transfer

Again, this is relatively simple and involves no action in the United States. But for it to be effective in this case a bank must be found outside the United States where two conditions are satisfied: the first is that Bankers Trust have a credit balance there of U.S.$131m. or more the second, that an account is also held there for the Libyan Bank or for some beneficiary whom they nominate.

(iii) C.H.I.P.S. or Fedwire

These are two methods of complex account transfer which are used for a high proportion of large dollar transactions. They can only be completed in the United States.

(iv) Banker's draft on London

A banker's draft is, in effect, a promissory note, by which the banker promises to pay to or to the order of the named beneficiary. When the beneficiary receives the draft he can negotiate it, or hand it to another bank for collection. If he negotiates the draft the beneficiary's part in the transaction ends. He has received all that he bargained for, and so far as he is

concerned no action in New York is required. Hence the view which emerges in the shipping cases that a banker's draft is as good as cash. But there still remains for the bank the task of honouring the draft when it is presented. The issuing bank, by debiting the customer's account and issuing a draft, has substituted one personal obligation for another. It still has to discharge the obligation represented by the draft. That it may do, in theory at any rate, by another of the means of transfer that are under discussion - in-house transfer, correspondent bank transfer, C.H.I.P.S., Fedwire, London dollar clearing, cash. So in one sense a banker's draft does not solve the problem; it merely postpones it. One cannot tell whether action is required in the United States until one knows how the draft is to be honoured.

There would be a further problem for the Libyan Bank if they received a draft from Bankers Trust. While the freeze was still operative the draft would in practice be difficult or impossible to negotiate, since nobody would want an instrument made by an American bank which on its face contained a promise to pay to or to the order of the Libyan Bank. That, as it seems to me, would be the case whether the draft was drawn on London or New York. If instead of negotiating the draft the Libyan Bank presented it to another bank for collection, the problem would have been postponed rather than solved for both parties. The Libyan Bank would receive no credit until the draft had been honoured; and Bankers Trust would have to use another means of transfer in order to honour it.

(v) Banker's payment

This is an instrument issued by one bank in favour of another bank. As the shipping cases show, it too is treated as the equivalent of cash in the ordinary way, so that the receiving bank might well allow the customer who presented it to draw against it forthwith. I am not sure whether that would happen in present circumstances, if the receiving bank knew that the banker's payment was issued for the account of the Libyan Bank.

Apart from the possibility of negotiation, which does not arise with a banker's payment, the same problem remains as with a banker's draft. It has to be cleared or honoured (whichever is the right word) by one of the other means of transfer under discussion. Normally the document will specify a clearing system which is to be used.

(vi) London dollar clearing

It may not be right to describe this as a means of transfer in itself, but rather as a method of settling liabilities which arise when other means of transfer are used, such as a banker's draft or banker's payment, or indeed a cheque. Bankers Trust are not themselves members of London dollar clearing, but use it through Lloyds Bank Plc.

Suppose H bank, also a member of the clearing, presented a banker's draft issued by Bankers Trust to or to the order of the Libyan Bank for U.S. $131m. At the end of the day net debits and credits of all the members of the clearing would be calculated - and settled by transfers in New York. As already explained, there would not necessarily be a transfer there of U.S. $131m. or any sum by Lloyds Bank or their New York correspondent to the New York correspondent of H bank. But somewhere in the calculation of the sum that would be

transferred by some bank in New York to some other bank in New York the U.S. $131m. would be found.

That is the first aspect of the transaction which requires action in New York. But thus far only the liabilities of the clearing members between themselves have been settled. What of the liabilities of the banks that have used the clearing but are not members? Bankers Trust owe Lloyds Bank U.S. $131m. That sum will go into a calculation of all the credits and debits between Bankers Trust and Lloyds Bank on that day; the net balance will be settled by a transfer in New York between Bankers Trust New York and Lloyds Bank or their New York correspondent.

Since I have assumed that H bank are a member of the London dollar clearing, no similar transfer is required in their case. They have already received credit for U.S.$131m. in the clearing process and the transfers which settled the balances which emerged from it.

There is another aspect of the London dollar clearing which featured a great deal in the evidence. This is that a rule, at the time unwritten, excluded from the clearing "cheques drawn for principal amounts of interbank Eurocurrency transactions." The system is described in the Child report, where it is said that "by mutual consent 'wholesale' interbank foreign exchange deals and Eurodollar settlements are excluded." That in turn raises a question as to the meaning of "wholesale." Bankers Trust argue that it includes transactions on interest-bearing call accounts between banks, at any rate if they are for large amounts. The Libyan Bank say that it refers only to transactions for time deposits traded between the dealing rooms of banks.

I prefer the evidence of Bankers Trust on this point. The reason for the exclusion appears to be that the introduction of a very large sum by one participant into the clearing system would impose an excessive credit risk. The average value of transactions passing through the system is U.S. $50,000, and the vast majority of items are of the order of U.S. $10,000. It is not normally used for transactions over U.S. $30m.; indeed, there were not many transactions in millions. I find that a transfer of U.S. $131m. by Bankers Trust to or to the order of the Libyan Bank would not, in the circumstances of this case, be eligible for London dollar clearing.

(vii) Other clearing systems outside the United States

Apart from the last point about eligibility, it seems to me that much the same considerations must apply to the other three systems discussed - Euroclear, Cedel and Tokyo dollar clearing. Although the identity of a particular transaction will be difficult or impossible to trace in the net credits or debits which emerge at the end of the clearing, these debits and credits must ultimately be settled in the United States. (The word "ultimately" constantly recurs and is of importance in this case, as was stressed in the course of the evidence.)

But whether that be so or not, there are other points relevant to the use of these systems. Euroclear in Brussels is a system run through Morgan Guaranty Trust Co. for clearing securities transactions and payments in respect of such transactions. If it so happened that Bankers Trust had a credit of U.S. $131m. in the system, it could arrange for that sum to be

transferred to the Libyan Bank or any nominee of the Libyan Bank which had an account with Euroclear. That would be a species of correspondent transfer. Alternatively, it could order the transfer to be made anywhere else - but that would involve action in New York.

Cedel, in Luxembourg, is similar to Euroclear in all respects that are material.

The Tokyo dollar clearing system is run by Chase Manhattan Bank at its Tokyo branch. Bankers Trust did not have an account with the system. If they had done, and had used it to pay U.S. $131m. to the Libyan Bank, they would have had to reimburse Chase Manhattan via New York.

(viii) Certificates of deposit

These are issued by banks for large dollar sums, and may be negotiable. Once again they raise the problem that one personal obligation of Bankers Trust would be substituted for another, and the substituted obligation still has to be honoured by some means at maturity. Furthermore, the terms of the certificate would be subject to agreement between the parties, in particular as to its maturity date and interest rate.

(ix) Cash - dollar bills

I am told that the largest notes in circulation are now for U.S. $100, those for U.S. $500 having been withdrawn. Hence there would be formidable counting and security operations involved in paying U.S. $131m. by dollar bills. Bankers Trust would not have anything like that amount in their vault in London. Nor, on balance, do I consider that they would be likely to be able to obtain such an amount in Europe. It could be obtained from a Federal Reserve Bank and sent to London by aeroplane, although several different shipments would be made to reduce the risk. The operation would take some time - up to seven days.

Banks would seek to charge for this service, as insurance and other costs would be involved, and they would suffer a loss of interest from the time when cash was withdrawn from the Federal Reserve Bank to the time when it was handed over the counter and the customer's account debited - assuming that the customer had an interest-bearing account. I cannot myself see any basis on which a bank would be entitled to charge, although there might be a right to suspend payment of interest. If a bank chooses, as all banks do for their own purposes, not to maintain a sum equal to all its liabilities in the form of cash in its vaults, it must bear the expense involved in obtaining cash when a demand is made which it is obliged to meet. If a customer demanded U.S. $1,000 or U.S. $10,000 in cash, I do not see how a charge could be made. When the sum is very much larger it is an important question - which I shall consider later - whether the bank is obliged to meet a demand for cash at all. If it is so obliged, there is not, in my opinion, any right to charge for fulfilling its obligation.

As I have already mentioned, it is accepted that there would be no breach of New York law by Bankers Trust in obtaining such an amount of cash in New York and despatching it to their London office.

(x) Cash - sterling

There would be no difficulty for Bankers Trust in obtaining sterling notes from the Bank

of England equivalent in value to U.S. $131m., although, once again, there would be counting and security problems. Bankers Trust would have to reimburse the Bank of England, or the correspondent through whom it obtained the notes, and this would probably be done by a transfer of dollars in New York. But, again, it was not argued that such a transfer would infringe New York law.

(f) Termination of the managed account arrangement

Those means of transfer are all irrelevant so long as the managed account arrangement subsists; for I have found it to be a term of that arrangement that all the Libyan Bank's transactions should pass through New York. Apart from some minor teething problems at the start in 1980, that term was observed. The only entries on the London call account were credits from, or debits to, the New York demand account. It was the New York account that was used to make payments to, or receive credits from, others with whom the Libyan Bank had business relations. If the arrangement still exists, the London account can only be used to transfer a credit to New York, which would be of no benefit whatever to the Libyan Bank.

In my judgment, the Libyan Bank was entitled unilaterally to determine the managed account arrangement on reasonable notice, which did not need to be more than 24 hours (Saturday, Sundays and non-banking days excepted). The important feature of the arrangement from the point of view of Bankers Trust was that their operators could make payments in New York, on occasion giving rise to an overdraft in New York, safe in the knowledge that there was a credit balance in London which they could call upon and which would not disappear. If it were determined, Bankers Trust New York would be entitled to refuse to make payments which would put the account there into overdraft. For the Libyan Bank an important feature was that they obtained both the speed and efficiency with which current account payments could be made in New York, and the advantage of an account in London bearing interest at Eurodollar rates. If the arrangement were determined and the Libyan Bank began once again to use the London account as if it were a current account, Bankers Trust would be entitled (again on notice) to reduce the rate of interest payable on that account, or to decline to pay interest altogether.

I find nothing surprising in the notion that one party to a banking contract should be able to alter some existing arrangement unilaterally. Some terms, such as those relating to a time deposit, cannot be altered. But the ordinary customer can alter the bank's mandate, for example by revoking the authority of signatories and substituting others, or by cancelling standing orders or direct debits; he can transfer sums between current and deposit account; and he can determine his relationship with the bank entirely. So too the bank can ask the customer to take his affairs elsewhere. In this case it does not seem to me at all plausible that each party was locked into the managed account arrangement for all time unless the other agreed to its determination, or the entire banking relationship were ended. I accept Mr. Cresswell's submission that the arrangement was in the nature of instructions or a mandate

which the Libyan Bank could determine by notice. For that matter, I consider that Bankers Trust would also have been entitled to determine it on reasonable notice - which would have been somewhat longer than 24 hours in their case. I hold that the arrangement was determined, implicitly by the Libyan Bank's telex of 28 April 1986, and if that were wrong, then expressly by their solicitors' letter of 30 July 1986.

What, then, was the position after determination? The New York account remained, as it always had been, a demand account. Subject to New York law, Bankers Trust were obliged to make transfers in accordance with the Libyan Bank's instructions to the extent of the credit balance, but they were not obliged to allow an overdraft - even a daylight overdraft, as it is called when payments in the course of a day exceed the credit balance but the situation is restored by further credits before the day ends. The London account remained an interest-bearing account from which Bankers Trust were obliged to make transfers on the instructions of the Libyan Bank, provided that no infringement of United States law in the United States was involved. If Bankers Trust became dissatisfied with the frequency of such transfers, they were, as I have said, entitled on notice to reduce the rate of interest or bring the account to an end. And if I had not held that the rights and obligations of the parties in respect of the London account were governed by English law at all times, I would have been inclined to hold that they were once more governed by English law when the managed account arrangement was determined, although there is clearly some difficulty in recognising a unilateral right to change the system of law governing part of the relations between the parties.

(g) Implied term and usage

It is said in paragraph 4(2) of the re-re-amended points of defence that there was an implied term that transfer of funds from the London account, whether or not effected through the New York account

"would be effected by instructing a transfer to be made by the defendants' New York Head Office through a United States clearing system to the credit of an account with a bank or a branch of a bank in the United States nominated or procured to be nominated by or on behalf of the plaintiffs for that purpose."

In other words, of the various forms of transfer which I have mentioned, only C.H.I.P.S. or Fedwire were permitted. That term is said to be implied (i) from the usage of the international market in Eurodollars, and (ii) from the course of dealing between the parties since 1980.

Mr. Cresswell submits that such an implied term is implausible on the ground that the foundation of the Eurodollar market is that deposits are not affected by the Federal Reserve requirement which I have mentioned. There may be some force in that. But I prefer to consider the affirmative case for the implication of such a term.

As to usage, I was referred to General Reinsurance Corporation v. Forsakringsaktiebolaget Fennia Patria [1983] Q.B. 856, and particularly the judgment of Slade L.J., at p. 874G:

"There is, however, the world of difference between a course of conduct which is frequently, or even habitually, followed in a particular commercial community as a matter of grace and a course which is habitually followed, because it is considered that the parties concerned have a legally binding right to demand it."

So I must inquire whether it is considered in the international Eurodollar market that creditors have a right to demand payment by C.H.I.P.S. or Fedwire and by no other means.

In Drexel Burnham Lambert International N.V. v. El Nasr [1986] 1 Lloyd's Rep. 356, 365, I cited and followed earlier authority that

"It had been laid down over and over again that the way to prove a custom was to show an established course of business, at first contested but ultimately acquiesced in."

There is no such evidence in this case. Mr. Sumption protests that that is not the only way to prove a usage, though it may be the best way. Of course he is right. So I must consider whether the usage has been proved by other means.

The expert evidence in this case has been immensely helpful in enabling me to understand what happens in the Eurodollar market and how different forms of operation work. But as evidence establishing a usage, or negativing one, it has achieved very little. In that it is similar to many other commercial cases of today. With monotonous regularity parties on the summons for directions apply for leave to call expert evidence of the practice of bankers, or of underwriters, or of insurance brokers, or of others engaged in the market concerned. All too often the evidence shows merely that the expert called by one party believes the contract to mean one thing, and the expert for the other believes that it means something different. But, as I have said, I do not seek to disparage expert evidence which enables the court to understand the market concerned.

The high point of Bankers Trust's case on this issue lies in the expert report of Dr. Stigum from which I quote some brief extracts:

"The usages and practices that apply to wholesale Eurodollar accounts are moreover, well understood by all wholesale participants in the Eurodollar market ... Cash transactions are a feature of only an insignificant portion of total Eurodollar deposits, namely those held by small retail accounts. At the wholesale level, the Eurodollar market is understood by all participants to be a strictly non-cash market. ... All wholesale Eurodollar transactions (these occurring not just in London, but in other centres around the world as well) must, unless they involve a movement of funds from one account at a given bank to another account at that same bank, be cleared in the United States. The reason for this custom and usage is that the ultimate effect of the clearing of a wholesale, Eurodollar transaction is to remove dollars from the reserve account of one bank at the Fed. to the reserve account of another bank at the Fed."

Even as it stands, that passage does not support the implied term pleaded, that transfers would be made "through a United States clearing system." However, it is fair to say that in the particulars of usage there were added by amendment to the points of defence the words "save where book transfers fall to be made between accounts at the same branch" -

which would allow, as Dr. Stigum apparently does, both an in-house transfer and a correspondent bank transfer.

Dr. Stigum is an economist and not a banker. I did not find her oral evidence impressive. On the other hand, Mr. Osbourne, who was until 1985 an assistant general manager of Barclays Bank, did seem to me an impressive witness, whose evidence was very sound on most points. His views were inconsistent with the usage alleged, at any rate in the case of an account such as that of the Libyan Bank with Bankers Trust London.

Furthermore, the supposed usage was inconsistent with the course of dealing between the parties, to which I now turn. It is, of course, true that from December 1980 to January 1986 all transactions by the Libyan Bank were carried out in New York. That is not in itself proof of a course of dealing, since, as I have found, there was an express term to that effect - until the managed account arrangement was brought to an end. What happened between 1973 and December 1980? Fortunately the parties agreed to treat one month as a suitable sample. That was December 1979, in which there were 497 transactions....

The vast majority of those transactions (402) were, as the suggested implied term required, through a United States clearing system. If one adds the in-house transfers of one kind or another in Bankers Trust, as Dr. Stigum's custom permits, the total reaches 488. But there were 9 transactions in that month alone (London bank drafts and a London banker's payment) which were not permitted, either by the implied terms which Bankers Trust allege or by Dr. Stigum's custom and usage, although they may very well have been for relatively small amounts.

I find difficulty in seeing how course of dealing by itself could support a negative implied term of the kind alleged. The phrase is often used to elucidate a contract or to add a term to it. But if course of dealing is to eliminate some right which the contract would otherwise confer, I would require evidence to show, not merely that the right had never been exercised, but also that the parties recognised that as between themselves no such right existed. In other words, there must be evidence establishing as between the parties what would be a usage if it applied to the market as a whole. But whether that be so or not, I find no implied term such as Bankers Trust allege to be established either by usage, or by course of dealing, or by both.

There was a great deal of evidence as to which Eurodollar transactions could be described as "wholesale" and which as "retail." I am inclined to think that the answer depends on the purpose for which the description is used. I have found that a payment of U.S. $131m. by Bankers Trust to the Libyan Bank would be excluded from London dollar clearing. In that context it may, perhaps, be described as wholesale. But I have also found that no usage applies to the Libyan Bank's account. I do not exclude the possibility that some usage applies to time deposits traded between the dealing rooms of banks. If the word "wholesale" is applied to that class of business, the Libyan Bank's account is not within it.

(h) Obligations in respect of the London account

Having considered and rejected the two methods by which Bankers Trust seek to limit their obligations in respect of the London account - that is, an express term from the managed account arrangement still subsisting, or an implied term - I have to determine what those obligations were. What sort of demands were the Libyan Bank entitled to make and Bankers Trust bound to comply with? As I said, earlier, it is necessary to distinguish between services which a bank is obliged to provide if asked, and services which many bankers do provide but are not obliged to.

Dr. F. A. Mann in his book The Legal Aspect of Money, 4th ed. (1982), pp. 193-194, discusses this question in the context of the Eurodollar market. I have given careful attention to the whole passage. His conclusion is:

"The banks, institutions or multinational companies which hold such deposits, frequently of enormous size, and which deal in them are said to buy and sell money such as dollars. In law it is likely, however, that they deal in credits, so that a bank which has a large amount of dollars standing to the credit of its account with another (European) bank probably does not and cannot expect it to be 'paid' or discharged otherwise than through the medium of a credit to an account with another bank. In the case of dollars it seems to be the rule (and therefore possibly a term of the contract) that such credit should be effected through the Clearing House Interbank Payments System (C.H.I.P.S.) in New York. ... In short, as economists have said, the Eurodollar market is a mere account market rather than a money market."

Dr. Mann cites Marcia Stigum's book, The Money Market (1978) and finds some support for his view - which he describes as tentative - in an English case which has not been relied on before me. The passage in question appeared for the first time in the 1982 edition of Dr. Mann's book after the litigation about the Iranian bank freeze.

I am reluctant to disagree with such a great authority on money in English law, but feel bound to do so. There is one passage, at p. 194, which appears to me to be an indication of economic rather than legal reasoning:

"it could often be a national disaster if the creditor bank were entitled to payment, for in the last resort this might mean the sale of a vast amount of dollars and the purchase of an equally large sum of sterling so as to upset the exchange rates."

But if a person owes a large sum of money, it does not seem to me to be a sound defence in law for him to say that it will be a national disaster if he has to pay. Countries which feel that their exchange rates are at risk can resort to exchange control if they wish.

Furthermore, the term suggested by Dr. Mann - that all payments should be made through C.H.I.P.S. - is negatived by the evidence in this case. It may for all I know be the rule for time deposits traded between the dealing rooms of banks, but I am not concerned with such a case here.

R. M. Goode, in Payment Obligations in Commercial and Financial Transactions (1983), p. 120, writes:

"Would an English court have declared the Executive Order effective to prevent the Iranian Government from claiming repayment in London of a dollar deposit maintained with a London bank? At first blush no, as it is unlikely that an English court would accord extra-territorial effect to the United States Executive Order. However, the argument on the United States side (which initially appeared to have claimed extra-territorial effect for the Order) was that in the Eurocurrency market it is well understood that deposits cannot be withdrawn in cash but are settled by an inter-bank transfer through the clearing system and Central Bank of the country whose currency is involved. So in the case of Eurodollar deposits payment was due in, or at any rate through, New York, and the Executive Order thereby validly prevented payment abroad of blocked Iranian deposits, not because the order was extraterritorial in operation but because it prohibited the taking of steps within the United States (i.e. through C.H.I.P.S. in New York) to implement instructions for the transfer of a dollar deposit located outside the United States."

That was published in 1983. I have not accepted the argument which Professor Goode refers to, that it is well understood that deposits cannot be withdrawn in cash. I find that there was no implied term to that effect.

I now turn again to the forms of transfer discussed in subsection (e) of this judgment, in order to consider in relation to each whether it was a form of transfer which the Libyan Bank were entitled to demand, whether it has in fact been demanded, and whether it would necessarily involve any action in New York.

(i) In-house transfer at Bankers Trust London
(ii) Correspondent bank transfer

I consider that each of these was a form of transfer which the Libyan Bank were entitled to demand as of right. But I find that no demand has in terms been made for a transfer by either method. This may well be because, in the case of an in-house transfer, there is no other institution with an account at Bankers Trust London which the Libyan Bank wish to benefit; and in the case of a correspondent bank transfer, the Libyan Bank have been unable to nominate a bank outside the United States which holds accounts both for Bankers Trust and also for the Libyan Bank or some beneficiary whom they wish to nominate. It is not shown that U.B.A.F. Bank Ltd. (referred to in the telex of 23 December 1986) fulfilled this requirement.

As to action in New York, none would have been required in respect of an in-house transfer at Bankers Trust London. Whether any would have been required in the case of a correspondent bank transfer depends on whether the correspondent bank in question did or did not already owe Bankers Trust U.S. $131m. or more. On the evidence, it is at the least unlikely that any bank outside New York could be found owing Bankers Trust U.S. $131m.

(iii) C.H.I.P.S. or Fedwire

There is no doubt that the Libyan Bank were entitled to demand such a transfer. But they did not demand it. Such a transfer would have required action in the United States which

was illegal there. The only doubt which I have felt on that point is as to whether the ultimate entries on the books of a Federal Reserve bank would have been so remote from the underlying transaction - being perhaps between different parties, for a different sum, and even in the opposite direction to the underlying transaction - that they would not be unlawful. Professor Felsenfeld, who gave evidence on behalf of the Libyan Bank, was inclined to think that such a transaction would be unlawful, and so was Mr. Knake. Professor Scott took a different view. Whichever be correct, I am convinced that some illegal action in the United States would be required by a C.H.I.P.S. or Fedwire transfer.

(iv) Banker's draft on London
(v) Banker's payment

Bankers Trust did not in practice issue banker's drafts on their London office. Instead they would provide a cheque drawn on Lloyds Bank Plc. That does not seem to me a point of much importance. I consider that Bankers Trust were obliged to provide such instruments to the Libyan Bank if asked to do so, subject to one important proviso - that the instruments were eligible for London dollar clearing. If they were not, then there was no such obligation, since in normal times and in the absence of legislation it would be simpler to use C.H.I.P.S. or Fedwire in the first place.

A banker's draft was demanded in the telex of 28 April 1986; and a banker's payment was within the description "any other commercially recognised method of transferring funds" demanded by the telex of 23 December 1986. But since, as I have found, an instrument for U.S. $131m. would not have been eligible for London dollar clearing in the circumstances of this case, Bankers Trust were not obliged to comply with that aspect of the demands.

It was argued that Bankers Trust might still have made interest payments through the London dollar clearing, since the exclusion is only of the principal amount of inter-bank Eurocurrency transactions. There are, in my judgment, three answers to that point. First, it is not relied on in the points of claim; secondly, there was no demand for interest payments as such; thirdly, the interest due had been capitalised once credited to the account. Indeed, if that were not so it would be impossible, or very difficult, to say how much of the U.S. $131m. was interest.

That makes it unnecessary to answer the question, which I regard as particularly difficult, whether the issue of a banker's draft or banker's payment by Bankers Trust to the Libyan Bank would necessarily involve illegal action in New York. Even if the instrument were cleared through London dollar clearing, action in New York would, as I have already mentioned, ultimately be required. (The same is true, in all likelihood, if one of the other clearing systems outside the United States had been used.) Although the identification of a particular payment would be even more difficult than in the case of a straight C.H.I.P.S. transfer, I am inclined to believe that Bankers Trust would have a second defence to a claim based on failure to issue such an instrument, on the ground that performance of their obligation would necessarily

involve illegal action in New York. However, Mr. Sumption appeared at one stage to accept that the issue of a draft drawn on London would not, or might not, involve illegal action in New York.

I need not consider problems as to the worth of a banker's draft or banker's payment to the Libyan Bank in present circumstances or the damages they would have suffered by not obtaining one.

(vi) London dollar clearing

(vii) Other clearing systems outside the United States

In effect these have already been considered. Bankers Trust were not obliged to issue an instrument with a view to its being passed through London dollar clearing if it was not eligible; and an instrument for U.S. $131m. in this case would have been disqualified.

The other clearing systems give rise to similar problems. There is no evidence that Bankers Trust had an existing credit of U.S. $131m. with Euroclear or Cedel arising from a transaction in securities, and they were under no obligation to acquire one. Nor were they obliged to become participants in the Tokyo dollar clearing. If they had done so, the issue of an instrument to be cleared in Tokyo would, as with London dollar clearing, have necessarily involved action that was illegal in the United States.

(viii) Certificates of deposit

The issue of these comes in my judgment into the class of service which banks habitually do provide but are not obliged to. If for no other reason, that is because agreement is involved, as to the maturity of the instrument and the interest rate. It cannot be that a customer is entitled to demand any maturity and any interest rate that he chooses. Nor would a reasonable maturity and a reasonable interest rate provide a practical solution.

In addition there would again be the problem whether a certificate of deposit could be honoured at maturity without infringing the law of the United States; and whether the Libyan Bank had suffered any damage by not obtaining one.

(ix) Cash - dollar bills

Of course it is highly unlikely that anyone would want to receive a sum as large as U.S. $131m. in dollar bills, at all events unless they were engaged in laundering the proceeds of crime. Mr. Osbourne said in his report:

"As to the demand for payment in cash, I regard this simply as the assertion of a customer's inalienable right. In practice, of course, where such a large sum is demanded in this manner, fulfilment of the theoretical right is unlikely, in my experience, to be achieved. sensible banker will seek to persuade his customer to accept payment in some more convenient form, and I have yet to encounter an incident of this nature where an acceptable compromise was not reached, even where the sum was demanded in sterling."

I would substitute "fundamental" for "inalienable"; but in all other respects that passage

accords with what, in my judgment, is the law. One can compare operations in futures in the commodity markets: everybody knows that contracts will be settled by the payment of differences, and not by the delivery of copper, wheat or sugar as the case may be; but an obligation to deliver and accept the appropriate commodity, in the absence of settlement by some other means, remains the legal basis of these transactions. So in my view every obligation in monetary terms is to be fulfilled, either by the delivery of cash, or by some other operation which the creditor demands and which the debtor is either obliged to, or is content to, perform. There may be a term agreed that the customer is not entitled to demand cash; but I have rejected the argument that there was any subsisting express term, or any implied term, to that effect. Mr. Sumption argued that an obligation to pay on demand leaves very little time for performance, and that U.S. $131m. could not be expected to be obtainable in that interval. The answer is that either a somewhat longer period must be allowed to obtain so large a sum, or that Bankers Trust would be in breach because, like any other banker they choose, for their own purposes, not to have it readily available in London.

Demand was in fact made for cash in this case, and it was not complied with. It has not been argued that the delivery of such a sum in cash in London would involve any illegal action in New York. Accordingly I would hold Bankers Trust liable on that ground.

(x) Cash - sterling

Dicey & Morris, The Conflict of Laws, 11th ed. state in Rule 210, at p. 1453:

"If a sum of money expressed in a foreign currency is payable in England, it may be paid either in units of the money of account or in sterling at the rate of exchange at which units of the foreign legal tender can, on the day when the money is paid, be bought in London ..."

See also Chitty on Contracts, 25th ed., para. 2105:

"Where a debtor owes a creditor a debt expressed in foreign currency ... the general rule is that the debtor may choose whether to pay in the foreign currency in question or in sterling."

Mr. Sumption argues that there is no such rule, at any rate since the decision in Miliangos v. George Frank (Textiles) Ltd. [1976] A.C. 443, that the judgment of an English court does not have to be given in sterling.

Since the Miliangos decision the rule in Dicey & Morris, or rather an earlier version of it, has been approved obiter by Mocatta J. in Barclays Bank International Ltd. v. Levin Brothers (Bradford) Ltd. [1977] Q.B. 270, 278. It must be admitted that the foundations of the rule appear to be somewhat shaky, and the reasoning upon which it has been supported open to criticism. Furthermore, in George Veflings Rederi A/S v. President of India [1979] 1 W.L.R. 59, Lord Denning M.R. said, at p. 63:

"I see no reason to think that demurrage was payable in sterling. So far as demurrage was concerned, the money of account was U.S. dollars and the money of payment was also U.S. dollars ... When you find, as here, that the demurrage is to be calculated in U.S. dollars and that there is no provision for it to be paid in sterling, then it is a reasonable inference that the

money is payable in U.S. dollars."

The rule in Dicey & Morris had been cited in the court below in that case; and it would appear at first sight that the Master of the Rolls disagreed with it. However, his conclusion evidently was that by implication the contract provided that demurrage should be paid only in U.S. dollars. In other words, the parties had contracted out of the rule. Furthermore, in that case a payment in sterling had in fact been made. The issue was not whether the charterer was entitled to pay in sterling, but how much credit should be given for the payment which he had made.

The pendulum swung the other way in In re Lines Brothers Ltd.[1983] Ch. 1. Both the Barclays Bank case and the George Veflings case were cited in argument. Oliver L.J., speaking of the argument of counsel for the creditors, said, at p. 25:

"Now his argument has an engaging - indeed an almost unanswerable - logic about it once one accepts his major premise, but it is here that I find myself unable to follow him, for what, as it seems to me, he is seeking to do is to attribute to the Miliangoscase a greater force than it has in fact. In effect what he seeks to do is to suggest that because Miliangos establishes that a creditor in foreign currency is owed foreign currency, it follows that the debtor is a debtor in foreign currency alone and cannot obtain his discharge by anything but a foreign currency payment. But this is to stand Miliangos on its head. What Miliangos is concerned with is not how the debtor is to be compelled to pay in the currency of the debt but the measure of his liability in sterling when, ex hypothesi, he has not paid and is unwilling to pay in the currency of the debt."

That, as it seems to me, is authority of the Court of Appeal that the Miliangos case does not affect the question whether a foreign currency debtor has a choice between payment in sterling and payment in foreign currency. I should follow the dicta of Oliver L.J. and Mocatta J., and the passages cited from Dicey & Morris, The Conflict of Laws, 11th ed. and Chitty on Contracts, 25th ed. That is also Dr. Mann's preferred solution and has the support of the Law Commission.

Still it may be agreed, expressly or by implication, that the debtor shall not be entitled to pay in sterling. There is no subsisting express term to that effect in the present case. Nor do I consider that such a term should be implied, in the present context of a banking contract where the obligation of Bankers Trust is to respond to demands of the Libyan Bank.

It remains to be considered whether there is a true or business option (see Chitty, para. 1387), such that payment in dollars is the primary or basic obligation but the debtor may choose to pay in sterling if it suits him to do so. Or are there alternative methods of performance, with the consequence described by Lord Devlin in Reardon Smith Line Ltd. v. Ministry of Agriculture, Fisheries and Food [1963] A.C. 691, 730:

"Where there is no option in the business sense, the consequence of damming one channel is simply that the flow of duty is diverted into the others and the freedom of choice thus restricted."

No other authority was cited on the point, and I feel that the material on which to decide

it is somewhat meagre. Given that a foreign currency debtor is entitled to choose between discharging his obligations in foreign currency or sterling, I consider that he should not be entitled to choose the route which is blocked and then claim that his obligation is discharged or suspended. I prefer the view that he must perform in one way or the other; so long as both routes are available he may choose; but if one is blocked, his obligation is to perform in the other.

A further complication arises from the fact that a bank's obligation is to respond to a demand, and there are or may be various different kinds of demand which a customer is entitled to make. When the general doctrine of Dicey & Morris, The Conflict of Laws, is considered in the context of a bank account such as that of the Libyan Bank, and there is (as I have held) no express or implied term that the obligation must be discharged only in dollars, I hold that the customer is entitled to demand payment in sterling if payment cannot be made in dollars. (I need not decide whether payment in sterling could be demanded if it was still possible to pay in dollars.) In this case there was an alternative demand for sterling in the telex of 23 December 1986; and it is not suggested that this would have involved any illegal activity in New York. I am not sure that it was a demand specifically for sterling notes, rather than an account transfer in sterling. But if the Libyan Bank were entitled to demand sterling, no separate point arises as to the manner in which it should be provided. So if I had not held that payment should have been made in cash in United States dollars, I would have held that it should have been made in sterling.

(2) The claim that a further sum should have been transferred from New York

This arises in three different ways on the facts. First it is said that U.S. $165.2m. should have been transferred to London at 2 p.m. on 7 January 1986.

Bankers Trust have two answers to this claim. First they say that instructions had been received and were pending for further payments to be made on 7 January after 2 p.m., which exceeded the amount then standing to the credit of the New York account (and, for that matter, the London account as well). It was only because further receipts also occurred after 2 p.m. that the New York account ended the day with a credit balance of U.S. $7.275m., and the London account remained untouched.

Secondly, Bankers Trust say that, if they were obliged to make a transfer to London on 7 January, they could lawfully have postponed it until after 8.06 p.m. New York time, when the first Presidential order came into force. Thereafter, they say, the transfer would have been illegal because it would have left the New York account overdrawn and would have constituted the grant of credit or a loan to the Libyan Bank.

In my judgment both those arguments fail. The telex of 27 November 1986, from which I have already quoted, contained this passage:

Each day, at 2 p.m., the balance position of your account is determined and any credits

received up to that time, less payments and less the peg balance, are immediately invested."

It is said that "payments" there are not confined to payments actually made, and include payments for which instructions were pending. In view of the precision with which the time of 2 p.m. is stated, and the word "immediately," I do not consider that to be right. Mr. Sumption argued that "immediately" is coloured (one might say contradicted) by the illustration given in the telex; but I do not agree. The argument that Bankers Trust were entitled to delay the transfer until after 8.06 p.m. also fails, for the same reason, and it is unnecessary to decide whether it would have been a breach of the first Presidential order to allow an overdraft in New York which was less than the credit balance in London. They would certainly have been entitled in any event not to make payments which exceeded the net credit balance of the two accounts. But after credits which were received during the afternoon there was no need to do that.

Mr. Sumption also argued that the passage in the telex set out above was merely an illustration of how the arrangement would work, and not part of the revised terms of the managed account arrangement. That argument I also reject.

Some attention was paid to the course of dealing on these points. Mr. Blackburn's evidence showed that there was no consistency in the treatment of unprocessed payments; sometimes they were taken into account in deciding whether a 2 p.m. transfer should be made, and at other times they were ignored. As to the actual timing of the transfer, it was always booked in New York on the same day, and in London on the following day with one day's back value. The important feature to my mind is that, so long as there was no legislative interference, it did not make any difference to the parties whether the actual transfer was made at 2 p.m. or at any time up to midnight. Banking hours in London had already ended. Nor did it necessarily make a difference whether unprocessed payments were taken into account; if they were not, and a debit balance in New York resulted at the end of the day, Bankers Trust would recall an appropriate amount next morning from London, with one day's back value. It was only when the Presidential orders came to be made that timing became important. Bankers Trust were, as I hold, in breach of contract in failing to transfer U.S. $165.2m. to London at 2 p.m. on 7 January.

If they had done so, they would have been entitled to recall U.S. $158.5m. from London next morning, so that the net loss to the London account was only U.S. $6.7m. Mr. Cresswell argues that, in practice, Bankers Trust only recalled sums from the London account late in the day, and therefore after 4.10 p.m. when the second Presidential order came into effect; a transfer from London would thereafter have been illegal. In point of fact that may well be correct. But I have no doubt at all that, if there had been a large overdraft on the New York account on the morning of 8 January 1986, Bankers Trust would on that particular day have recalled the appropriate sum from London with the utmost despatch.

No transfer to London having in fact been made on 7 January, and no recall the next morning, U.S. $6.7m. should then have been transferred, as the amount by which the New York balance exceeded the peg of U.S.$500,000. The only issue of potential importance here is

whether the transfer was actually made. Although preparations were made for effecting the transfer, I am satisfied that it was countermanded and did not take effect. There is no need for me to decide precisely when the transfer ought to have been made, since that is subsumed in the next point.

The Libyan Bank's third complaint under this head is that, no transfers between New York and London having in fact been made at 2 p.m. on 7 January or in the morning of 8 January, the balance in New York at 2 p.m. on 8 January was U.S. $161,997,000. It is said that a sum of U.S. $161.4m. should then have been transferred to London. In answer to that Bankers Trust rely on points that are the same as, or similar to, those raised in respect of 2 p.m. on 7 January: they say that they were entitled to take pending payment instructions into account; and that they were entitled to delay payment until after 4.10 p.m. when the second Presidential order had been made, which certainly prohibited such a transfer. I reject both arguments for the reasons already given, based on the telex of 27 November 1985. It is true that if the pending payment instructions were to be executed in the afternoon, there were grounds for apprehension that the New York account would become overdrawn, which might be a breach of the first Presidential order; and even that the total of both accounts would be overdrawn, which would plainly be a breach of that order. The solution for Bankers Trust was not to execute those pending instructions unless and until further credits were received in New York. Some were in fact received - the New York account ended the day in credit to the extent of U.S. $251,129,000. Payment instructions for that day totalled U.S. $347,147,213.03, and none of them were in fact executed. So on any view the New York account would have been overdrawn if all had been executed, and that much more overdrawn if in addition U.S. $161.4m. had been transferred to London at 2 p.m. But the net total of the two accounts would still have been a credit balance. If Bankers Trust took the view that an overdraft on the New York account would itself be a breach of the Presidential order, and if they were right, the solution as I have said was to execute the pending instructions only as and when credits received permitted them to do so.

Accordingly I hold that (i) Bankers Trust were in breach of contract in failing to transfer U.S. $165.2m. to London at 2 p.m. on 7 January; (ii) if they had done that, they could and would have recalled U.S. $158.5m. from London in the morning of 8 January; but, (iii) on the assumption that both those steps had been taken, there would have been a further breach in failing to transfer U.S. $154.7m. to London at 2 p.m. on 8 January. (I trust that the calculation of this last figure is not too obscure. The 2 p.m. transfer on 8 January should have been U.S. $161.4m. if neither of the previous transfers had been made - as in fact they were not. If they had both been made, the figure would have been reduced to U.S. $154.7m.)

The balance resulting from those three figures is a net loss to the London account of U.S. $161.4m. I hold that this must be added to the Libyan Bank's first claim, as an additional sum for which that claim would have succeeded but for breaches of contract by Bankers Trust. It is said that this loss is not recoverable, because it arose from a new intervening act and is too

remote. In the circumstances as they were on 7 and 8 January I have no hesitation in rejecting that argument.

(3) Failure to comply with payment instructions

As pleaded, the Libyan Bank's case is that their payment instructions on 8 January 1986 ought to have been honoured to the extent of U.S. $226,147,213.88, and were not. That figure is calculated in Mr. Blackburn's exhibit C.8. It assumes (i) a transfer of U.S. $6.7m. to London on the morning of 8 January, (ii) no 2 p.m. transfer on 7 or 8 January, and (iii) that the New York account is not allowed to become overdrawn at any time. So for this purpose the Libyan Bank are content to accept that an overdraft on the New York account alone would be a breach of the first Presidential order. Or else they are assuming the success of their claim (1) for U.S. $131m., in which case the maximum for which claim (3) can succeed is the figure stated above.

I have to approach it on a different assumption, in the light of my conclusions hitherto. If a net total of U.S. $161.4m. had been transferred to London by 2 p.m. on 8 January, the payments that could have been made before 4.10 p.m. would have totalled some U.S. $89m. I am satisfied that in the ordinary way those payments would have been made before 4.10 p.m. The last credit that day was received at 3.03 p.m., which would have left sufficient time for the processing of payment instructions, and C.H.I.P.S. normally closed at 4.30 p.m., although on this occasion it was extended first to 5 p.m. and then to 5.30 p.m. I am also satisfied that the reason no payments were made was apprehension that this might be unwelcome to the Federal Reserve Bank of New York or the Treasury if a freeze were imminent. Nevertheless I do not consider that there was any breach of contract by Bankers Trust in not making any payments before 4.10 p.m., when it became illegal for them to carry out their instructions. There obligation was to make the payments that day, and not at any particular time in the day. Mr. Cresswell submitted that there was an implied term that Bankers Trust would not act on the instructions of a third party. I do not see why that should be so. Provided that they were not in breach of any obligation as to acting on the instructions of their customer, it does not seem to me to matter whether they acted on their own initiative or at the suggestion of somebody else.

In any case, if failure to make the payments had been a breach of contract it would have caused the Libyan Bank no loss. One might suppose that all or at any rate most of the payments were designed to discharge liabilities of the Libyan Bank or to create new obligations owed to the Libyan Bank, although it is always a possibility that some of them may have been ordered for no consideration in favour of causes which the Libyan Bank desired to support. But the Libyan Bank have expressly declined to put forward a case that they have had to or will have to make the payments from other sources, or that they have not obtained credits from others which otherwise they would have obtained. They prefer to take their stand on the point that they now have a credit balance which is frozen in New York, which they would not have had if the payments had been made. As a matter of law that does not seem to me a sufficient allegation of loss. Nor do I think that any case of injury to the Libyan Bank's reputation has been

made out.
Claim (3) therefore fails, on two grounds.

(4) Breach of duty of confidence

The facts as I have found them are that in the morning of 8 January 1986 Mr. Brittain of Bankers Trust told the Federal Reserve Bank of New York that "it looked like the Libyans were taking their funds out of the various accounts." Later he told Mr. Corrigan that this earlier report had been a false alarm - meaning, I suppose, that funds were coming in to replace payments that had been ordered. There was no mention of Libyan Arab Foreign Bank by name. But the New York Fed. probably knew which Libyan banks held accounts with Bankers Trust.

Neither side suggests that New York law as to the duty of confidence owed by a banker to his customer is any different from English law. Nor is it argued that the information was given under compulsion of law. But Bankers Trust say that they were entitled to act as they did (a) because their own interests required them to do so, (b) because the Libyan Bank must be taken impliedly to have consented, or (c) pursuant to a higher public duty. In that connection I was referred to Tournier v. National Provincial and Union Bank of England [1924] 1 K.B. 461. There Bankes L.J. included, at p. 473: "where there is a duty to the public to disclose" among the exceptions to a banker's duty of confidence.

Scrutton and Atkin L.JJ. on the other hand spoke of the duty to prevent fraud or crime, at pp. 481 and 486.

I do not accept that disclosure was required in Bankers Trust's own interests, in the sense of the first exception relied upon; or that there was implied consent by the Libyan Bank. But I have more difficulty over the point about higher public duty. In England there is statutory power in section 4(3) of the Bank of England Act 1946 and section 16 of the Banking Act 1979 for the Bank of England to obtain information from banks. It was not argued that I should presume a similar legal power in the New York Fed. in relation to banks in New York. But presuming (as I must) that New York law on this point is the same as English law, it seems to me that the Federal Reserve Board, as the central banking system in the United States, may have a public duty to perform in obtaining information from banks. I accept the argument that higher public duty is one of the exceptions to a banker's duty of confidence, and I am prepared to reach a tentative conclusion that the exception applied in this case.

I need not reach a final conclusion on that point, because I am convinced that any breach of confidence there may have been caused the Libyan Bank no loss. It is not suggested, and there is no evidence to show, that the second Presidential order would not have been made when it was but for the information passed by Mr. Brittain to the New York Fed. What is suggested is that, if that information had not been passed, the payments would have been made before 4.10 p.m. I am not convinced as to that. Suppose that Mr. Brittain had talked to the New York Fed. in a way that involved no breach of confidence - for example by asking whether he could lawfully make a large payment in the light of the first Presidential order; the

result would in all probability have been exactly the same. Any breach of confidence was incidental. It did not of itself cause the payments not to be made. And even if it did, I have held in section (3) above that the Libyan Bank have not established any loss by reason of the fact that the payments were not made.
Claim (4) also fails.

(5) Frustration

This claim is pleaded as an alternative ground for awarding the Libyan Bank the relief sought under claims (1) and (2). Since I have held that those two claims succeed, I can deal briefly with the topic of frustration.

Section 1 of the Law Reform (Frustrated Contracts) Act 1943 provides:
"(1) Where a contract governed by English law has become impossible of performance or been otherwise frustrated, and the parties thereto have for that reason been discharged from the further performance of the contract ... (2) All sums paid or payable to any party in pursuance of the contract before the time when the parties were so discharged ... shall, in the case of sums so paid, be recoverable from him ..."

It is said that the U.S. $131m. credit in the London account, and the additional amount of U.S. $161.4m. which should have been transferred to the London account, are the balance of sums paid in the past by the Libyan Bank to Bankers Trust; that the contract between them has become impossible of performance or been frustrated, by reason of the Presidential order prohibiting repayment; and that consequently those sums are recoverable from Bankers Trust under section 1 of the Act or at common law.

So paradoxical an argument requires scrutiny. The first answer to it is in my judgment that the obligation of Bankers Trust was suspended but not discharged: Arab Bank Ltd. v. Barclays Bank (Dominion Colonial & Overseas) Ltd. [1954] A.C. 495, and see also the observations made in the Court of Appeal in that case [1953] 2 Q.B. 527. Mr. Cresswell seeks to distinguish that case on the ground that special rules apply to the outbreak of war. That is no doubt true to some extent; but I see no ground for holding that war has a different effect on the obligations of a banker from any other kind of supervening illegality for present purposes. Accordingly I would hold that the contract as a whole has not become impossible of performance or been otherwise frustrated; or at any rate that the parties have not been altogether discharged from further performance.

A second answer is, I think, that payments made by the Libyan Bank to Bankers Trust were not paid "in pursuance of the contract." There was no obligation on the Libyan Bank to deposit sums with Bankers Trust. So these were not payments comprised within section 1 of the Act.

As to the alternative restitutionary remedy at common law, the consideration given by Bankers Trust has not wholly failed. They are still obliged to repay one day, and meanwhile to credit interest to the account.

If it had been material, I would have held that claim (5) failed.

(6) Failure to make transfers in due time between April 1984 and November 1985

Logically this claim might have been considered first, since it is not at all concerned with the freeze but with events that occurred earlier.

The facts are that from December 1980 onwards under the managed account arrangement Bankers Trust were obliged to review the New York account every morning, and transfer the excess of U.S. $500,000 in multiples of U.S. $100,000 to the interest-bearing call account in London with value the previous day. What they in fact did from April 1984 onwards was to review the account at 2 p.m., and make a transfer to London if appropriate on the basis of that review with value that day. Bankers Trust did not lose by the change, since a further transfer from London with that day's value was made if operations between 2 p.m. and the close of business diminished the New York account below U.S. $500,000. If, on the other hand, those operations increased the closing balance above U.S. $599,999, the Libyan Bank did lose, because they did not obtain that day's value in their London interest-bearing account for the excess, but only the next business day's value. They would lose interest for one day, or for three days if a week-end intervened.

The change was made unilaterally by Bankers Trust, after they had unsuccessfully tried to persuade the Libyan Bank to agree to an increase in the peg balance, and without informing the Libyan Bank. Later, in November 1985, it is accepted that the Libyan Bank did agree to it prospectively. It has not been suggested that the change was anything other than a breach of contract at the time when it first occurred in April 1984; nor that there would be any defence to the claim in English law. But it is said that, under New York law, the Libyan Bank are precluded from relying upon the breach by their failure to complain about entries in their bank statements, or by the doctrine of account stated, or by an estoppel.

I have found that the Libyan Bank did not in fact appreciate what was happening until mid-1985; but they could have detected earlier that they were not receiving the full benefit by way of interest to which they were entitled, if they had looked at their bank statements with a fair degree of diligence.

I am prepared to assume that New York law does govern this aspect of the relations between the parties, if and to the extent that I have not already held that it does.

Evidence of New York law on this topic was given by Professor Felsenfeld on behalf of the Libyan Bank and Mr. Knake on behalf of Bankers Trust. Professor Felsenfeld's opinion was that failure by the Libyan Bank to comment on the bank statements would not excuse Bankers Trust for an intentional, negligent or culpable act on their part; that Bankers Trust would have to establish that they relied on the conduct of the Libyan Bank and acted on it to their detriment; and that they could not disclaim responsibility for their own good faith or their duty to exercise ordinary care. There was not a great deal of dispute as to those propositions, and to the extent

that there was I prefer the evidence of Professor Felsenfeld. But the real question here was as to the facts. The Professor was asked this question in re-examination:

"Suppose a bank goes to its customer and tries to alter the basis on which interest is charged so as to improve the return to the bank and the customer refuses to agree to the new arrangement that the bank proposes, and that subsequently the bank introduces another arrangement in the hope that the customer won't spot it. Is the bank acting bona fide in that way, or not?"

and the Professor answered: "I think you have described a rather flagrant example of bad faith." Mr. Knake was not wholly prepared to accept that; but I am. He was asked this question by me at the conclusion of his evidence:

"I have just one question for you, Mr. Knake, and it is on that same topic. We have been talking about duty of care. For the present, although my view may be changed, I have difficulty in seeing how there was any lack of care on the part of Bankers Trust. It seems to me they acted with great care. It is more a case of deliberate and calculated breach. If that be right what is your view on the account stated argument?" (An agreed correction has been made to the transcript.)

Mr. Knake answered:

"If that were to be your Lordship's finding then I would agree that under those circumstances if in fact they were, that is, Libyan Arab Foreign Bank were deceived, then I would have to agree with that, the absence of an account stated under those circumstances."

The facts as I have found them amount in substance to what was put to Professor Felsenfeld and Mr. Knake. Bankers Trust have no defence to this claim under New York law.

It is fair to add that in correspondence Bankers Trust alleged that they were only doing what other bankers habitually did. There was some modest support for that in the evidence of Mr. Blenk. But it has not been relied on before me as justification in law for the action of Bankers Trust.

The Libyan Bank are entitled to damages to be assessed in respect of this claim. There was mention in Mr. Cresswell's penultimate speech of another way of putting the claim - that on some days (other than 7 and 8 January) not even a 2 p.m. transfer was made when it should have been. I did not understand that to be one of the complaints on which the Libyan Bank came to court, and I have not considered or ruled upon it.

Conclusion

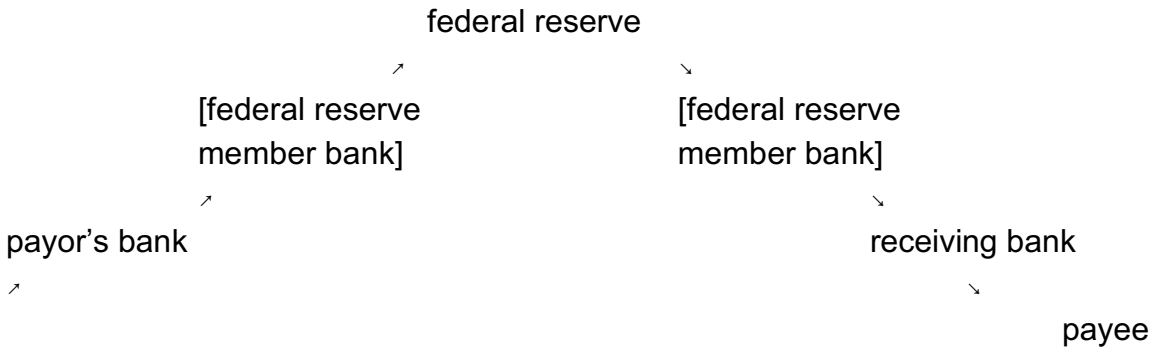
The Libyan Bank are entitled to recover U.S. $131m. on claim (1) and U.S. $161m. (the amount of their demand) on claim (2). Claims (3) and (4) fail. Claim (5) would have failed if it had been material. On claim (6) the Libyan Bank must have judgment for damages to be assessed.

Postscript

In August of this year there were 20 working days. Fourteen of them were entirely consumed in the preparation of this judgment. In those circumstances it is a shade disappointing to read in

the press and elsewhere that High Court judges do no work at all in August or September and have excessively long holidays.

The decision suggests that there are a number of options for clearing US dollar payments. Fedwire is a real-time gross settlement system for settling payments in US dollars.[21] The payor instructs her bank to make the payment which must pass through the federal reserve system using banks which are members of that system. If the payor's bank and or payee's bank are not members they must involve correspondent banks which are members in the transaction.



CHIPS[22] is a real time net settlement system. In Fedwire all payments are made without taking account of other payments, so if Bank A must make $100 million payments to Bank B in any one day and Bank B must make $50 million payments to Bank A each transfers the gross amount. In a net system the participants may be able to transfer only the net amount. A net system has greater liquidity than a gross system, but may have greater risk, so CHIPS has complex systems for minimizing risk.

Should the illegality in the US have excused Bankers' Trust's failure to pay Libyan Arab Bank? What do you think of Staughton's split proper law? Why was Staughton so sceptical about some of the expert evidence?

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[21] See, e.g., http://www.federalreserve.gov/PaymentSystems/FedWire/ NB. Target is the real time gross settlement system for euro. You can find information on Target here: http://www.ecb.int/paym/html/index.en.html .

[22] *See* http://www.chips.org