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INTEREST RATE SWAPS - THE HAMMERSMITH AND FULHAM CASE

Mr Patten's letter to the Chancellor of 24 October was written against a background in which it was reasonable to think that the House of Lords would probably follow the Court of Appeal in saying that interest rate swaps could be intra vires in certain circumstances. However, even in that situation many of Hammersmith's transactions and some of those carried out by other authorities would have been unlawful.

The important point is that transactions which are ultra vires are not necessarily and for all purposes void. The Court of Appeal was clear on this, saying that "it is sometimes necessary to accept that "what's done is done" and even if it should not have been done, the law should lean in favour of such solution as enables the situation to be so far as possible rectified with minimum loss and inconvenience to all concerned". The banks will presumably seek to enforce their contracts even if all of them have been declared ultra vires the powers of local authorities and, of course, legal opinions are divided as to likely outcome.

The Government has consistently made it clear that it will not make lawful that which the courts find unlawful but must accept that unlawfulness may not mean that all the swaps are un-enforceable at law. The next step in the process is for the courts to establish what in principle can be enforced and then for Government to co-ordinate efforts to make sure that orderly settlement is organised out of court wherever and as quickly as possible. That would go a long way to repairing damage done to the reputation of the London market and the local authorities themselves. It must also be a necessary pre-condition for any new set of rules which would allow local authorities to use similar instruments of debt management in the future.

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