Kluwer Arbitration Blog

Swaps in Portugal: A Case for Arbitration

Paula Costa e Silva (University of Lisbon, Faculty of Law) · Thursday, January 14th, 2016

and Duarte G. Henriques, BCH Lawyers

1. Until very recently the swaps industry seemed to be reluctant to use alternative dispute resolution or at least was very indifferent as to the choice of the dispute resolution mechanism, with disputes almost always being left for the courts of either London or New York to decide, these two jurisdictions providing a substantial level of quality and speed in resolving disputes. Arbitration was virtually unheard of in the financial industry in general and in the swaps business in particular. This landscape has been changing in recent years, and arbitration is now becoming increasingly common in financial and banking transactions. The swap players are not being left behind.

2. Indeed, globalisation and the increase in international trade, which have caused the use of new financial products to spread to other jurisdictions, particularly those of developing countries and emerging markets, have recently begun to show that litigation might not be the best available means to solve disputes in this area. Concerns as to geographic distance, jury trials and punitive damages have been raised by banks located in other jurisdictions not familiar with these feature. Moreover, court decisions do not benefit from the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards of 1958.

Despite the fact that within the European Union framework, many court decisions may benefit from the legal regime arising from Council Regulation (EC) No. 1215/2012 of 12 December 2012 (“Brussels Regulations”), this regime does not apply to enforcement of court decisions outside the European territory.

3. On the other hand, it is worth noting the example of the ISDA Master Agreements (1992 and 2002 versions) because they cover around 90% of all transactions in derivatives, including swaps. Not surprisingly, ISDA has been making great efforts not only to extend the use of arbitration mechanisms among its members, but also to include this option in its Master Agreement.

4. Notwithstanding the (small) dimension of the market, the Portuguese case law shows now a considerable and interesting number of cases decided by the courts over the past few years in swap related matters. In fact, this experience shows that the use of arbitration not only is practicable, but it is also a good option to resolve disputes in the swaps context.

Not only are issues of enforcement of the arbitration agreement at stake but, more importantly, intricate questions regarding the notion of “unexpected change in circumstances” (giving rise to the

doctrine of “hardship”), the validity of a swap agreement under the doctrines of “gaming or wagering” (“*jeu et pari*”) contracts and, lastly, but not less importantly, the (possible) violation of Portuguese public policy.

Let us look now at such experience, starting by the cases where the validity of the arbitration clause was disputed.

5. In this respect, there are already a reasonable number of cases demonstrating how the Portuguese courts have been lending support to the use of arbitration in swap-related disputes.

Indeed, out of sixteen cases decided by the Portuguese courts since 2011, nine were related to the validity of the arbitration clause inserted in the standard form contract.

In eight of those nine cases, the superior courts (six decisions were delivered by the Courts of Appeal and three by the Portuguese Supreme Court of Justice) upheld the validity of the clause, thus dismissing the claim on the grounds of the “Kompetenz – Kompetenz” principle.

These cases back up the notion that arbitration clauses inserted in swaps contracts, even if by way of reference made to a contract of adhesion (“Master Agreement”), are considered valid and enforceable.

6. On another topic, the swaps contracts have been contested on the grounds that they equate to “gaming and wagering” (“*jeu et pari*”) contracts.

Indeed, three other decisions concerned the issue of whether a swap contract amounts to a “gaming and wagering” contract, thus contaminated by nullity under Art. 1245 of the Portuguese Civil Code (one decision of the Lisbon Court of Appeal, one decision of the Porto Court of Appeal and one decision of the Portuguese SCJ).

While the Lisbon Court of Appeal annulled the swap contract considering it to be a “gaming and wagering” contract (Decision of the Lisbon Court of Appeal of 21 March 2013), the Porto Court of Appeal and the Supreme Court of Justice decided in the opposite direction (Decisions of the Porto Court of Appeal of 28 October 2015 and of the Portuguese Supreme Court of Justice of 11 February 2015.

7. Regarding yet another legal theory, the particular circumstances experienced by the Portuguese economy in the global environment related to the dramatic fall in interest rates in the aftermath of the world financial crisis of 2008, led to the assertion that swaps ought to be considered capable of being terminated under the theory of “unexpected and considerable change in circumstances” (giving rise to the theory of “hardship”) set forth in Art. 437 of the Portuguese Civil Code.

In fact, two decisions were related to the issue of whether the dramatic fall in the Euribor rates following the 2008 financial crisis amounted to a “hardship” condition entailing the option granted to the aggrieved party to terminate the contract under the theory of “unexpected and unfair change in the circumstances” / “hardship” (Art. 437 of the Portuguese Civil Code). Both the Guimarães Court of Appeal and the Supreme Court of Justice, in two unrelated cases, agreed with this premise, thus annulling the swaps contracts (Decisions of the Guimarães Court of Appeal of 31 January 2013 and of the Portuguese Supreme Court of Justice of 10 October 2013).

8. On one singular and different occasion the Portuguese Supreme Court of Justice considered the

swap contract at hand to be in violation of Portuguese public policy (Decision of the Portuguese Supreme Court of Justice of 29 January 2015).

In this case, the Supreme Court addressed the question of whether the swap contract had a merely speculative character only and, if so, whether it should be considered in violation of Portuguese public policy. The Supreme Court of Justice reached the conclusion that the lack of a match between the "speculator" factor of the swap contract and the hedge (coverage of a particular financial risk) led to the conclusion that such contract should be classified as purely speculative.

The Supreme Court went further and asserted that the legal system does not tolerate financial speculation without restriction: some kinds of speculation are healthy for the economy and are morally acceptable, while other kinds of speculation, especially those which do not have any connection with real and actual risks, are substantially hazardous in social and economic terms ("*spéculation hasardeuse*"). In the case at hand, the Supreme Court could not find such a match and therefore considered that the contract had a purely speculative nature, and was not admissible at the social and economic levels. Consequently, the contract was in breach of Portuguese public policy and, therefore, ought to be considered null under Art. 280(2) of the Portuguese Civil Code.

9. A final note should be given to a particular ground upon which the swaps contracts have been challenged, which is a theory that asserts the invalidity of the particular standard form contracts ("Master Agreement") at hand due to a lack of sufficient and appropriate information that ought to be provided to clients by the brokers, banks and other financial institutions. The consequence of this legal theory is that a standard form contract will be null if the proponent has not provided the client with sufficient information as to the contents of the applicable general contractual framework.

In all the cases where this challenge was raised, the courts dismissed the claim on the grounds of the "Kompetenz – Kompetenz" principle (as seen above) and, therefore, the court did not have the chance of going into the merits of this contention. However, the answer to that question will certainly depend on the circumstances of the case.

10. As a conclusion, we should be worried, not regarding the validity of the arbitration clause, but certainly regarding the "hardship" and "gaming & wagering" challenges that may arise in the context of swap-related disputes.

All these matters have to be properly dealt with by the decision maker.

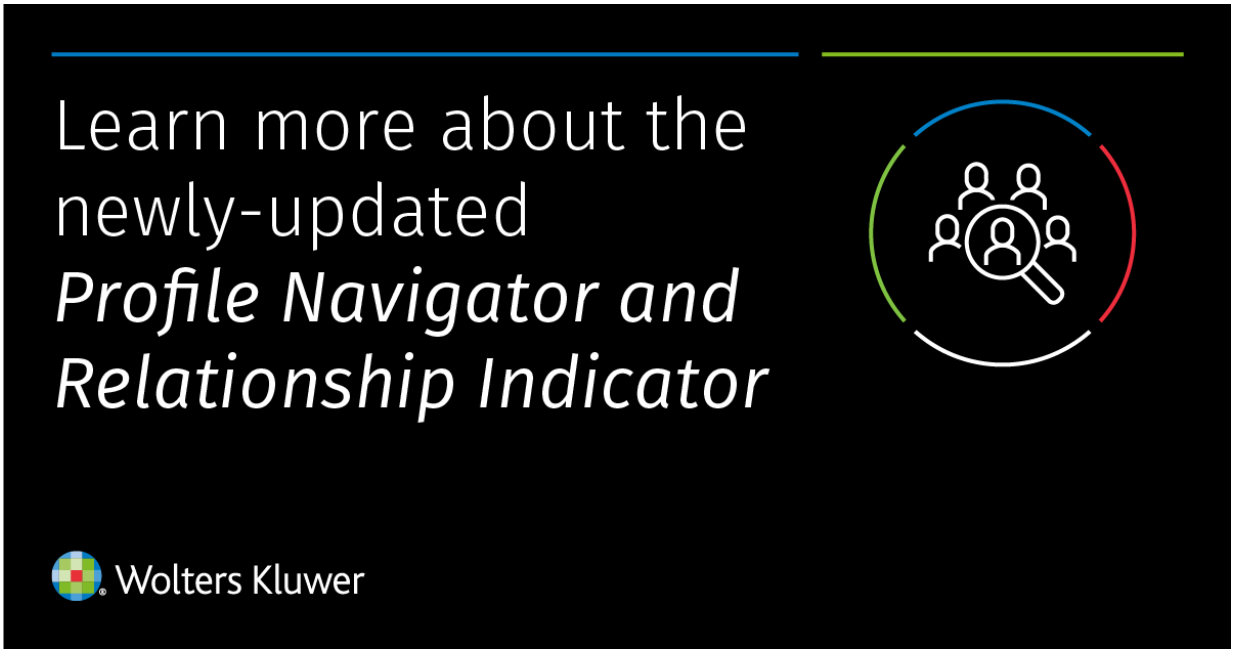
These observations lead us to conclude that the expertise of the decision maker (that arbitration is in general in a better position to provide) and, on the other hand, the enforcement of the arbitration clause inserted in numerous swaps contracts, make arbitration a good solution for solving disputes in this arena.

This post is a summary of an article to be published in "Arbitration International" (Oxford University Press).

To make sure you do not miss out on regular updates from the Kluwer Arbitration Blog, please subscribe here. To submit a proposal for a blog post, please consult our Editorial Guidelines.

Profile Navigator and Relationship Indicator
Includes 7,300+ profiles of arbitrators, expert witnesses, counsels & 13,500+ relationships to uncover potential conflicts of interest.

Learn how **Kluwer Arbitration** can support you.



This entry was posted on Thursday, January 14th, 2016 at 7:33 pm and is filed under Arbitration, Financial Agreements, Financial Industry, kompetenz-kompetenz, Portugal, Swap
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.