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The International Public Policy of the Portuguese State: A Matter of Value?

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1. I have written elsewhere about the uncertainty that the Portuguese courts have experienced in defining the "international public policy" of the Portuguese State and, more specifically, in finding in some particular cases that there was a situation amounting to a violation of that standard for the purposes of annulment of (or refusal to recognise) international arbitral awards. (See Duarte G. Henriques, 'I Will Not Go That Way: What The International Public Policy Of The Portuguese State Is Not', in MEALEY'S International Arbitration Report Vol. 30, 2 February 2015)

Although the Portuguese courts have been consistent in setting up the theoretical foundations of the "international public policy" (i.e. as the fundamental principles underpinning the national legal order and, therefore, the conception of justice of the Portuguese State regarding the substantive law), the outcome when applying those standards to each case has not always been the same.

2. For example, on 9 October 2003, the Portuguese Supreme Court of Justice decided that the right to a fair and adversarial process, the right of access to justice and the ''pact sunt servanda'' amount to such fundamental values encapsulated by the notion of international public policy of the Portuguese State. (See decision of the Portuguese Supreme Court of Justice of 09 October 2003, decisions of the "Supremo Tribunal de Justiça", Ref. 03B1604)

Conversely, in a decision of 21 February 2006, the same Supreme Court considered that a case where the final decision had not been notified ''in persona'' to the party, but rather to its attorney, did not violate its "international public policy". (See decision of the Portuguese Supreme Court of Justice of 21 February 2006, decisions of the "Supremo Tribunal de Justiça", Ref. 05B4168)

3. In a similar vein, the Portuguese courts have already decided that an arbitral award with a short or defective motivation (but not a total lack of reasoning) is not in violation of the public policy of Portugal. (See decision of the Portuguese Supreme Court of Justice of 10 July 2008, decisions of the "Supremo Tribunal de Justiça", Ref. 08A1698, and decision of the Lisbon Court of Appeal of 29 November 2007, decisions of the "Tribunal da Relação de Lisboa", Ref. 5159/2007-2)

Significantly, in this case both the Lisbon Court of Appeal and the Portuguese Supreme Court of Justice addressed an issue arising from a penalty that the respondent had been ordered to pay to the claimants by an arbitral tribunal seated in Lisbon. In this case, the claimants and the respondent had entered into a shareholders' agreement that, among other things, set forth a supplementary capital payment to be made by each shareholder, coupled with a penalty due from any defaulting

shareholder. This penalty was to be twice the amount of the supplementary capital payment due. The respondent failed to timely make the additional payment of around € 2,340,000, which was eventually made 15 days after the expiry of the deadline. The claimants initiated arbitration seeking, inter alia and as an alternative to other remedies, the payment of twice such supplementary capital payment (i.e. € 4,680,000). The arbitral tribunal considered the amount resulting from the penalty clause excessive and thus reduced the amount due to the claimants to half that amount (i.e. the original € 2,340,000). The respondent subsequently initiated proceedings aimed at annulling the arbitral award and contended, inter alia, that the "penalty clause" at hand was in violation of the public policy of the Portuguese State. Both the Lisbon Court of Appeal and the Supreme Court of Justice decided that such a stance did not imply a violation. The courts were also asked to consider whether such a clause was a true "penalty clause" or rather a "liquidated damages" clause, and refused to do so because such analysis would force them to look at the merits of the case, which was prevented by law. By the same token, the courts refused to consider whether an "excessive" penalty clause would be in violation of the public policy.

4. This background would seem to show that a penalty clause does not violate the public policy of the Portuguese State, let alone its "international public policy", which is narrower than the mere "domestic public policy". However, a recent decision of the Supreme Court of Justice indicates otherwise.

5. Indeed, in its decision made on 14 March 2017, the Portuguese Supreme Court of Justice addressed the question whether a "penalty clause" inserted in the articles of association of an Iberian law firm would entail a violation of the "international public policy" of the Portuguese State. (See decision of the Portuguese Supreme Court of Justice of 14 March 2017, decisions of the "Supremo Tribunal de Justiça", Ref. 103/13.1YRLSB.S1)

The Iberian law firm in question was subject to a set of contractual regulations, namely an "Agreement for the Professional Integration and Regulation of the Corporate Relationships of the Law Firm C" and its "Articles of Association", both containing a penalty clause set forth for, inter alia, the breach of "non-competition" and "non-solicitation" obligations, binding its associated and partner lawyers, along with a clause providing for arbitration in Barcelona. The penalty clause provided that a partner in violation of these obligations would be bound to pay compensation of three times the value of the amounts paid in the last three years to the lawyers implicated and an additional compensation of three times the value of the amounts invoiced to the clients involved in the solicitation in the previous three years. In the case at stake, the outcome of applying the penalty clause was a total amount of over € 4,900,000, which was equivalent to more than 25 years of that partner's income. This penalty clause was upheld by a sole-arbitrator, who decided the case in absentia of the former lawyer-partner in question. This Portuguese partner then resisted the recognition in Portugal of the arbitral award at stake, claiming that such recognition would be in violation of the international public policy of Portugal. The case eventually reached the Supreme Court.

6. Laying down the foundations of the standards applicable to the "international public policy", the Supreme Court started by noting that the said public policy is formed by principles underpinning the legal order, and that are part of the Constitution itself and of the Acquis Communautaire, especially those protecting fundamental rights such as good faith, "bonos mores", prohibition of abuse of rights, proportionality, prohibition of expropriation and discriminatory measures, prohibition of penalties in civil matters, and basic principles and rules of competition, both of domestic and European source.

The Supreme Court went on to consider that while those principles are subject to stricter constraints (that is, to a narrower understanding) when applied to the recognition of foreign arbitral awards, this recognition may never result in a manifest disregard of the international public policy. According to the Supreme Court, such disregard occurs when the indemnity awarded comes to a disproportionate amount that blatantly clashes with the Portuguese "bonos mores", with the principle of good faith, and with the principle of proportionality (or prohibition of excess). Further, such recognition may never result in a restriction of fundamental constitutional rights such as the right of freedom of professional choice, and the freedom of economic initiative.

The Portuguese Supreme Court of Justice thus refused to grant recognition of the foreign arbitral award at hand.

7. There remain no doubts that regarding the potential barring of recognition of a foreign arbitral award, the "international public policy" (of the Portuguese State) must be assessed considering the outcome of that recognition. It is nevertheless disturbing to learn that, in the first case (annulment of an arbitral award), the Supreme Court was very scrupulous regarding looking at the contents of the award that ordered the respondent to pay a penalty, even though there was no evidence that the creditors of such clause (the claimants) had been harmed by a 15-day delay in making a supplementary capital payment, while, in a similar situation, the Supreme Court showed no reluctance in going into the merits of the case only to find the outcome of the foreign arbitral award in manifest contradiction with the "international public policy" of the Portuguese State.

At the same time, the outcome of these two cases is a paradox. In fact, the "international public policy" standards are much narrower when it comes to denying the recognition of foreign arbitral awards—and therefore this bar applies to a substantially lower number of cases—when compared to the standards applicable to the annulment of awards that might contradict the (merely domestic) public policy. Yet, in a case concerned with the recognition of a foreign arbitral award, the Supreme Court used a broader understanding of what amounts to a violation of the "international public policy".

The least we could posit is that it ought to be the other way around.

Or was it just a matter of value—and if so, what value is it then acceptable to find as not being in violation of the "public policy"? The answer seems hard to find.

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