

P.R.I.M.E. Finance

Panel of Recognized International Market Experts in Finance

Jurisprudence Panel: Portugal



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Presentation by **Pedro Cardigos**
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Portugal

A – Jurisdiction - 5 cases of Regional Companies of Madeira (ISDA documentation)

- a) Supreme Court Decisions (26-01-2016, 21-04-2016 and 04-02-2016)
- b) Supreme Court acknowledged the Brussels I Regulation interpretation issuer and referenced it to the ECJ, and
- c) The last one, an Appeals Court decision, was suspended waiting for the ECJ's decision.

B – Substantive Law Issues (Local Documentation)

- i. **Supreme Court Decision** (05.03.2016) – swaps can have hedging and/or pure speculation purposes, and that **does not** violate internal public order
- ii. **Lisbon Appeal Court** (10.05.2016) – limits to validity to be found, not at the public order level, but at *misselling* and *appropriateness* stages (governed by the good faith principle).
- iii. **Lisbon Appeal Court** (27.09.2016) – abnormal change of circumstances was upheld, but a *serious breach* of the principle of good faith was required.

C – Mandatory Provisions of Portuguese Law in an ISDA Agreement (English Law)

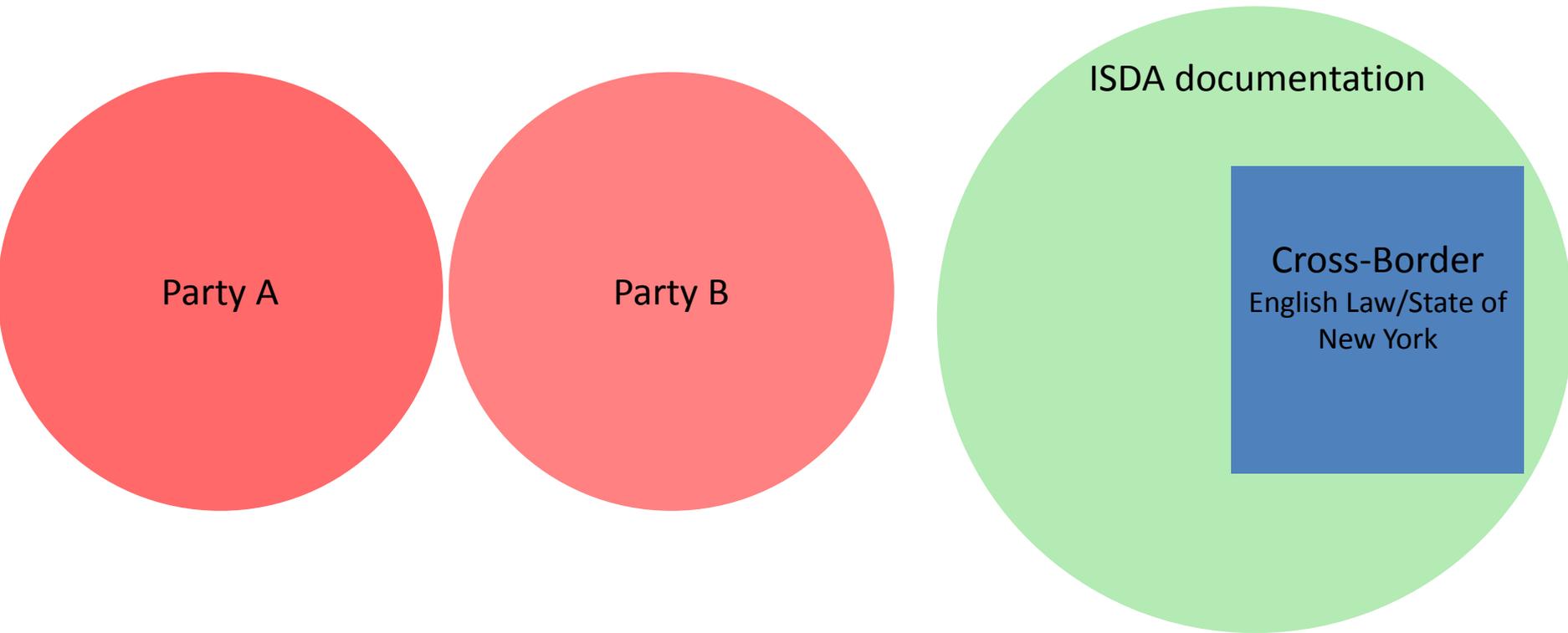
Santander Totta vs [Portuguese Transport Companies]

Article 3(3) of the Rome Convention and the Portuguese CC regime of Abnormal Change of Circumstances (*hardship*)



Portugal

Cross - Border case - Each Parties' Legal System vs. Law Chosen by the Parties



Party A

Party B

ISDA documentation

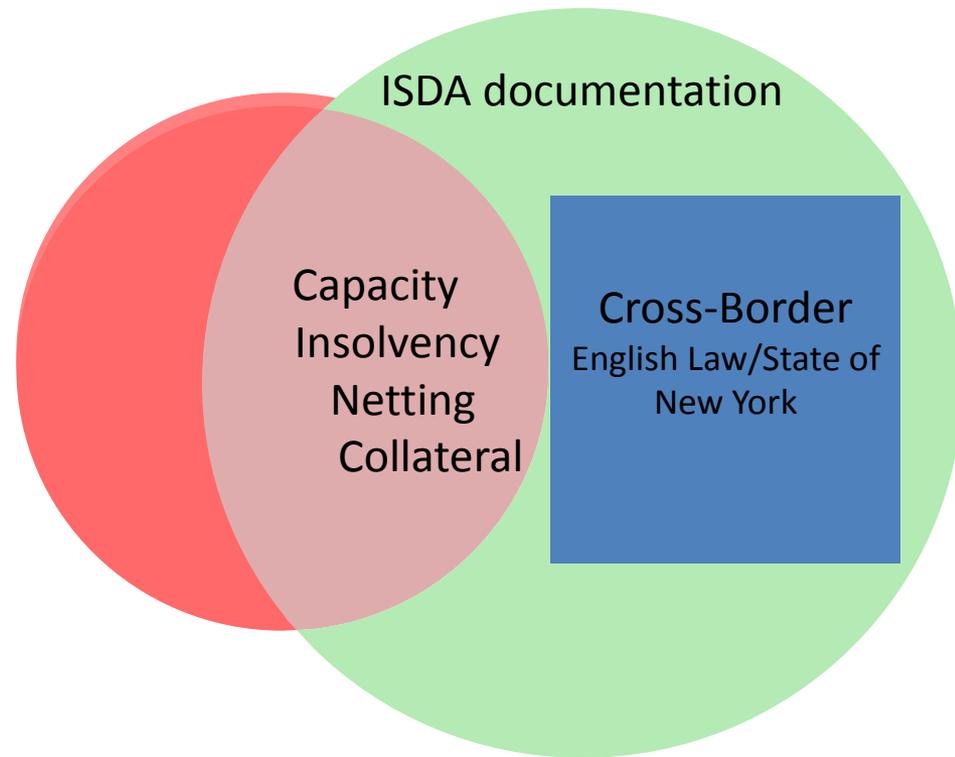
Cross-Border
English Law/State of
New York



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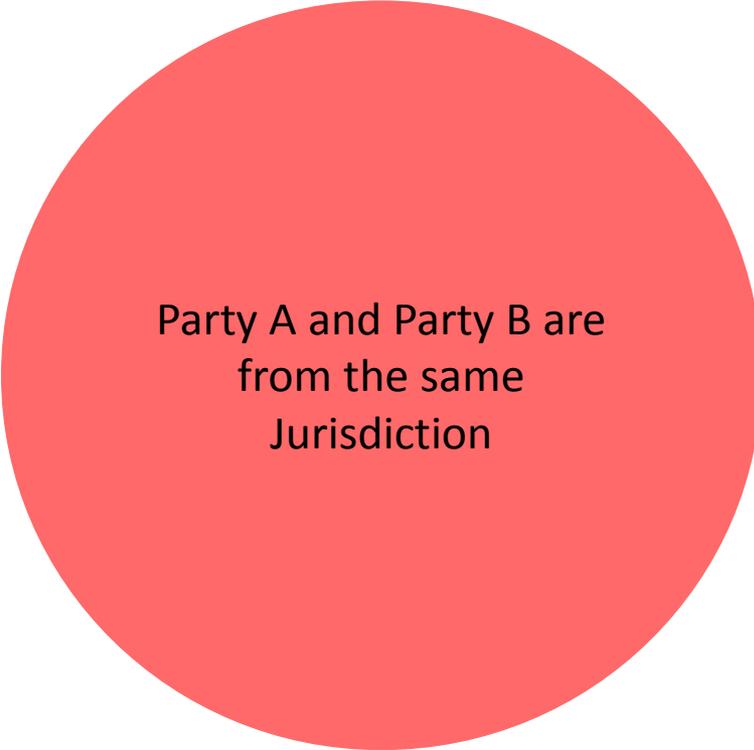
Portugal

However, Parties' local law may apply to Transactions under ISDA

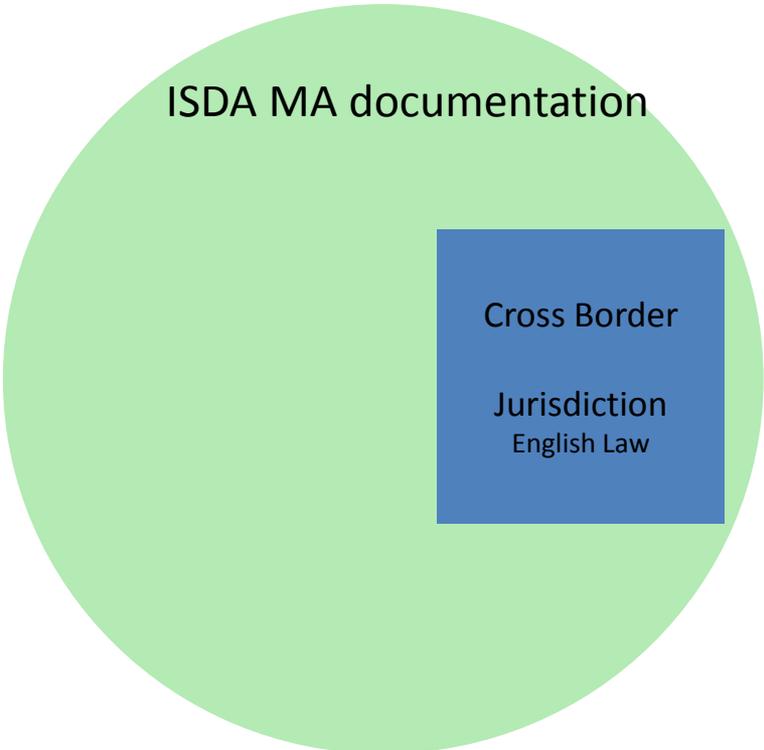


Portugal

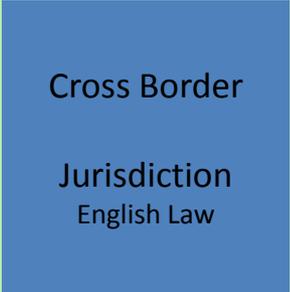
Even absent a proper conflict of laws, the parties can elect another law to apply.



Party A and Party B are
from the same
Jurisdiction



ISDA MA documentation



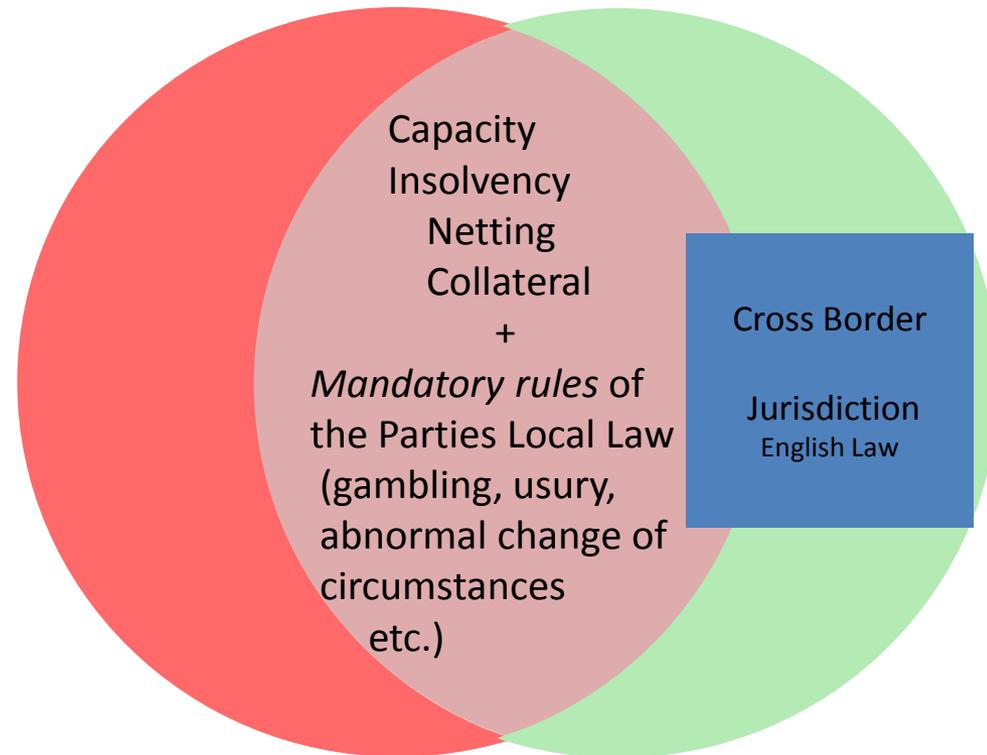
Cross Border

Jurisdiction
English Law



Portugal

Local Law vs. ISDA documentation Choice of Law



Portugal

Article 3(3) of the Rome Convention (Law Applicable to Contractual Obligations)

*“The fact that the parties have chosen a foreign law, whether or not accompanied by the choice of a foreign tribunal, **shall not, where all the other elements relevant to the situation at the time of the choice are connected with one country only, prejudice the application of rules of the law of that country which cannot be derogated from by contract, hereinafter called ‘mandatory rules’.**”*



Portugal

Details of the case:

- 1st case of the Financial List, heard by J Blair - decided on **4 March 2016**. An appeal was filed and was decided on **13 December 2016** - permission to appeal to the Supreme Court was requested on **10 January 2017**.
- In all started in 2013, when 4 claims had been filed with the Commercial Court against 4 Portuguese State Owned Transport Companies
- BST requested the Court to confirm the validity and enforceability of 9 swaps (with a MtM value of 1,3 billion Euros)
 - All agreed under ISDA documentation (1992 MA)
 - Choice of English law and English courts



Portugal

All contractual elements were connected with Portugal

- I. A Portuguese Bank (100% held by a Spanish bank).
- II. 4 Portuguese State Owned Transport Companies (entities managing the Lisbon and Oporto subways infrastructures and bus companies).
- III. Agreement executed and to be performed in Portugal.

The Transactions

- i. 9 IRSwaps (long term - 9 to 20 years) entered into between 2005 and 2007.
- ii. highly leveraged, with accruing memory features (*snow balls*).
- iii. 7 to be triggered if a low (or a high) interest rate level barrier was crossed.
- iv. referenced to Euribor or Libor; the low barriers were set at 1.5% or 2% and the high barriers at 6% or 8% - two swaps had only high barriers.



Portugal

The Armageddon:

1. In March 2009 the low barriers were crossed (and the reference interest rates remained under ever since).
2. A *RISK* magazine article in May 2014 identified one of these swaps as the *Worst Trade of All Times* – this swap payments carried at the time the article was published an interest rate of 40.6%.
3. This swap now carries and interest rate of 93.7%.
4. The remaining swaps interests range from 33% to 99%.
5. If the reference interest rates remain below 1,5% or 2%, interests on swap payments can reach close to 190%.



Portugal

The Legal Issues (findings of the Court):

1. *“Had Portuguese law applied to the swaps, 7 of the 9 swaps would have been modified or terminated”* (J Blair) [Article 437 of the CC, abnormal change of circumstances]
2. The Appeals Court further considered Article 437 *“a provision of Portuguese law that cannot be derogated by contract”*.
However..
3. **J Blair and the Appeals Court ruled Rome Convention Article 3(3) not applicable to this case** (contrary to *Dexia Crediop S.P.A. vs Comune di Prato*, a case decided in the same Commercial Court in June 2015 by J Walker).



Portugal

Article 3(3) of the Rome Convention:

*“The fact that the parties have chosen a foreign law, whether or not accompanied by the choice of a foreign tribunal, shall not, **where all the other elements relevant to the situation at the time of the choice are connected with one country only**, prejudice the application of rules of the law of that country which cannot be derogated from by contract, hereinafter called ‘**mandatory rules**’.”*



Portugal

Elements of connection
in a conflict of laws
sense

- i. Parties
- ii. Place of Execution
- iii. Place of Performance

Elements relevant to the
situations' international
nature

- i. 100% held by Spanish Bank
- ii. International Industry Agreement (ISDA)
- iii. Down the chain “back-to-back” swaps
- iv. Underlying debt
- v. Assignment provision
- vi. International derivatives market



Portugal

When does Article 3(3) apply?

- A. It applies only when no “relevant” *international element exists* (i.e., a purely domestic case.)

- B. It applies in the absence of an element connecting the situation to a legal system of another country (in a conflict of laws sense) – other ... than the choice of law itself.



Portugal

The Rome Convention drafting Commission compromise:

Absent an element connecting the situation to another legal system, the parties should still be permitted to choose a law other than their own.

However, by doing that, they would not be allowed to set aside “mandatory provisions” of their own legal system.

The Courts’ view in Santander Totta (J. Blair/Appels Court):

Only in a situation of absence of any “relevant” international element, would the *mandatory provisions* of the parties legal system be accepted.

In short: the choice of the ISDA documentation, the assignment possibility under Section 7, the “down the chain” back-to-back swaps with foreign 3rd parties, the underlying debt from ECB loans, may all be of relevance to set Article 3 (3) of the Rome Convention aside.

