NEWSLEXTTER

THE YEAR IN REVIEW

ARBITRATION

PLMJ

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SOCIEDADE DE ADVOGADOS, RL

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Editorial Contents:

"Best Portuguese Law Firm for Client Service"- Client Choice - International Law Office, 2008

"Portuguese Law Firm of the Year"- IFLR Awards 2006 & Who's Who Legal Awards 2006, 2008

Editorial - The PLMJ Investment in Arbitration

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The arbitration section is one of our priorities here at PLMJ and an easy one to justify. Our acknowledged leadership in litigation in Portugal has naturally given rise to a significant number of cases where PLMJ lawyers are chosen to sit as arbitrators, represent parties, give expert evidence or work with colleagues from other countries in the preparation of arbitration proceedings where Portuguese law or facts which took place in Portugal are relevant.

Despite the scarcity of information resulting from the confidential nature of arbitration, I believe that today PLMJ is also a leading firm in the field of alternative dispute resolution. Nine PLMJ partners have already sat as arbitrators (in national cases as well as in international cases involving Brazilian and Angolan law), while over 15 lawyers are regularly involved in arbitration at PLMJ.

As a result, we have bet heavily on specialisation and training: recently five PLMJ lawyers completed the first post-graduate course in arbitration held in Portugal, all with very high scores. PLMJ partners are members of national and international arbitration associations, run the Portuguese branch of international associations, and one of us is the Country Reporter for the prestigious ITA. In addition, we attend all the main international arbitration congresses which allows us to keep abreast of the most recent complex developments around the world.

We strongly recommend our clients and colleagues to insert arbitration clauses in their contracts and we firmly support institutional arbitration at respected entities such as the ICC; LCIA, NAI, SCA as well as the Lisbon and Oporto Commercial Associations Commercial Arbitration Centres here in Portugal.

This newsletter aims to increase the amount of information available about arbitration in Portugal and we intend to do so regularly in the future.

The Litigation Costs Regulation and the (New) Reform of Enforcement Proceedings: Coerced Arbitration and Coercive Measures in Arbitration

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The year 2008 has seen several new developments in terms of the legislation applicable to arbitration, though the oft-discussed reform of the Voluntary Arbitration Law has not yet seen the light of day.

Two decree-laws deserve our attention here - the effects of which, in theory, should be felt in 2009[1] -Decree-Law 34/2008 of 26 February,[2] which passed the Litigation Costs Regulation and the very recently enacted Decree-Law 226/2008 of 20 November, which will (again) restructure the enforcement system, providing for the first time for institutionalised arbitration within the scope of legislative reform.

The first of these two decree-laws has acknowledged the right of the winning party to be compensated for expenses incurred during the proceedings. A new Article 447-D, which lays down the right to this compensation, has been added to the Civil Procedure Code, although its implementation in Articles 25 and 26 of the Litigation Costs Regulation raises some doubts.

Nevertheless, this long-awaited measure (which was rejected until now on the basis of a view of free access to justice which we believe to be wrong) is obscured by Clause 4 of the above-mentioned Article 447-D(4), which states:

> *"A claimant who, though able to use alternative dispute resolution structures, opts for court proceedings, shall be liable for his own costs regardless of the outcome of the claim, save when the other party has made it impossible to use that particular type of alternative resolution for the dispute."*

It is anybody's guess what 'able to use alternative dispute resolution structures' means. If any kind of arbitration clause exists, the parties are obliged to go to arbitration and the courts must refrain from hearing such disputes. Yet even if there is no such clause, the vast majority of private law disputes – with the exception of personal status actions– may be submitted to arbitration.

If this is the case, the only possible conclusion is that a party cannot recover his costs whenever he decides to go to court with a dispute concerning alienable rights. It should be pointed out that these costs, apart from lawyers' fees, include court fees and expenses incurred with the action. Only in cases where a party proposes arbitration to the other party prior to filing the action, and the other party refuses (or fails to respond), will this not be the outcome.

This amendment is expected to come into force on 6 January 2008.

The second measure concerns the possibility of resorting to institutionalised arbitration for enforcement purposes.

Article 11 and thereafter of the above-mentioned Decree-Law 226/2008 of 20 November provide for the creation of voluntary arbitration centres to settle disputes arising from enforcement proceedings, completely ruling out court intervention with the sole exception of authorisation for forcible entry into an individual's home or the registered office of a company.

It is specifically provided that arbitration depends on the parties making the choice expressly, since it requires an arbitration clause and, within certain limits, grants the parties the power to revoke the clause unilaterally.

This decree-law is expected to come into force on 31 March 2009.

This is not the place for lengthy considerations about these measures but we should at least draw attention to the fact that the primary goal[3] of these measures is to unclog the courts; yet this should not be the driving force behind this type of reform.

While we vigorously defend the benefits of arbitration, we believe that there are various fundamental ideas underlying these benefits, one of which is "voluntariness", that is, the parties should be able to choose to go to arbitration.

Yet in order to solve a problem that most parties who actually resort to the courts can not be blamed for – the overcrowded courts – it has been decided that parties who do not go to arbitration will lose out on the possibility of recovering everything they spend on the action, even if their claim is wholly successful.

This becomes even more serious when, as a result of the new Litigation Costs Regulation, there will be an advantage for large claims (large in terms of costs) in resorting to the courts. The distinction is incomprehensible.

In relation to the second decree-law, we know of no other legal order where a similar solution has been tried. Traditionally, one of the other characteristics of arbitration is the arbitrators' lack of enforcement power, which means that arbitrators' decisions can only be enforced through the courts and the arbitrators themselves must request the cooperation of the court if they intend to compel a party or other participant to behave in a given manner.

So it seems that we are innovating yet again, though we are not sure whether this is the right path to take.

1
The entry into force of one has already been postponed once.

2
Even before coming into force, this has already been amended by Law 43/2008 of 27 August and Decree-Law 181/2008 of 28 August.

3
Clearly stated in the preamble to Decree-Law 226/2008.

From the outset, it is arguable whether this is true arbitration, since although it is still voluntary (at least for now) it can only take place in institutions supervised by the state itself. It seems however that the intention of the lawmakers is to create, outside of the state justice structure, one (or more entities) which are private in nature but subject to state supervision, whose purpose is to solve the problems the state was unable to solve.[4]

Further, one of the reasons in favour of state court intervention in the enforcement of the decision is the belief that it is useful for the state to have some control over arbitration.

Experience shows that, generally speaking, private management is more efficient than its public equivalent, but is it right to privatise justice? Or are we heading towards a commingling of the two, with a view to implementing a kind of para-state arbitration?

It is clear that whether or not 2009 will be the year in which these measures materialise, it will certainly be a year in which more developments are to come in relation to these two themes.

4
There are in fact similarities with the community courts or *julgados de paz* but this time it was decided to call them arbitration centres.

Public Order and Domestic Arbitration

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The Supreme Court in its Ruling of 10 July 2008 (Case No.08A1698, at www.dgsi.pt) stated that:

> *"When an arbitral award is in breach of a public order provision, the award will necessarily be void, but when the conflict with public order lies within the arbitral award itself, all its effects must be denied by recourse to general legal criteria".*

Despite having asserted the above principle, the court did not ultimately apply it to the facts it was appreciating because it considered that the arbitral tribunal's decision in recognising the claimants' rights to compensation due under a penalty clause, regardless of whether or not damage was actually proved, did not constitute an offence against any public order provision or principles.

Although the issue has not been settled, this assertion calls into question superior court jurisprudence which to date has been consistent in its view that the list of grounds in Article 27(1) of the Voluntary Arbitration Law – Law 31/96 of 29 August is a closed list.[1]

However, this decision views the violation of public order principles or provisions as grounds for the annulment of an arbitral decision, with the supreme Court of Justice declaring[2] that *"the public order violation, though not included in the closed list of grounds for annulling arbitral awards set out in Article 27 of the above-mentioned law 31/86, must be allowed as a cause for annulment of this type of decision by application of the general principles of law".*

This position is not a new one, and is based on the proposition of Paula Costa e Silva[3] who, drawing attention to the fact that public order operates as a limit to the application of law by the courts, concluded that a judgment – judicial or arbitral – which offends against this public order will always be void or voidable.

Luís de Lima Pinheiro[4] too puts forward a similar understanding, claiming just one single criterion for the definition of what is international and internal public order, which reinforces its absolutely exceptional nature.

In our view, this ruling – at least in what appears to be the most correct interpretation – deserves to be criticised, firstly because Article 27 of the Portuguese Voluntary Arbitration Law contains a closed list of grounds for annulment.

Secondly, it should be noted that the distinction between national and international arbitration in terms of the possible consequences of a claim of contempt for public order could always have some reason for being. In fact, according to our law, it is presumed that there is no appeal from an arbitral award in international arbitration (unless the parties specifically agree to this). In domestic arbitration, this appeal is the rule and may only be excluded by agreement of the parties which, in itself, is a dichotomy requiring different levels of assurances.[5]

Further, it is in international arbitration, due to the meeting of completely different legal systems, that the possibility of an offence against the international public order of one of the states involved increases exponentially. The risk of an equally serious offence occurring in relation to domestic arbitration is much less likely.

1
In this sense, merely as an example, see the previous decisions of the Supreme Court of Justice: Ruling 24 October 2006 in the Court Reports (*Colectânea de Jurisprudência*) no. 159, year XIV, vol. III, p. 81 and Ruling 11.03.1999 (*at* www.dgsi.pt, Case No. 98B1128), the Lisbon Appeal Court Ruling of 14 June 2000 in the Court Reports (*Colectânea de Jurisprudência*, vol. III, p. 167) and Oporto Appeal Court Ruling of 18.06.2008 (at www.dgsi.pt; Case No. 0726831).

2
Using the public order definitions of Menezes Cordeiro, Paulo Mota Pinto and Manuel Andrade.

3
"*Anulação e Recursos da Decisão Arbitral*" – ROA, 1992, p. 944 (cited in the Ruling).

4
"*Apontamentos sobre a Impugnação da Decisão Arbitral*", ROA, Ano 67 (2007), p. 1030 *et seq..;* cf. also "*Arbitragem Transnacional – A Determinação do Estatuto da Arbitragem*", Almedina, p. 279.

5
Noting for example that the question could be put in a different way in legal orders which only provided for annulment action as the sole mechanism of challenging the arbitral award, as is the case with arbitration law in Macao, Spain and Brazil.

Fourthly, the fact that domestic and international arbitrations are equated for this purpose is based on the postulation that all foreign arbitral decisions may be challenged in Portugal under Article 5(2)(b) of the New York Convention (if applicable) and Article 1096 of the Civil Procedure Code if they violate the international public order of the Portuguese State. However, this will not necessarily be the case if the decision in question is purely one of dismissal.

Fifthly, if the concept of international public order is already in itself indeterminate and capable of generating controversy, its adaptation or transposition at an internal level may lead to even greater difficulties.

Sixthly, the reasoning used in the Ruling would have to apply *mutatis mutandis* to the decisions of the Supreme Court of Justice itself, thus putting an end to any notion of legal certainty.

Finally, we should not lose sight of the fact that two of the fundamental characteristics of arbitration, as we see it, are voluntariness (meaning that only those who want to will be submitted to arbitration) - a principle which has undergone several attacks this year. and definiteness (meaning that arbitral decisions are, as a rule, definitive).

The conclusion therefore is that the decision of the Supreme Court of Justice in its 10 July 2008 Ruling, by defending a more guarantee-based view of the arbitration proceedings, has in fact created greater uncertainty and insecurity as regards the unchallengeability of the arbitral award.

Nevertheless, as the matter was only dealt with in passing and flies in the face of the prevailing jurisprudence, we are sure that further developments are likely in 2009.

Access to Justice, Free Will and Financial Hardship

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The Constitutional Court in its Ruling of 30 May 2008[1] decided that

> *"Article 494(j) of the Civil Procedure Code, when interpreted to the effect that the* objection *of breach of the arbitration clause may be enforceable against a party in a state of supervening financial hardship necessitating free legal aid, in a dispute regarding behaviour to which this state may be attributable, is unconstitutional since it is in violation of Article 20(1) of the Constitution."* [2]

The issue in question originated in a legal action filed in a court in opposition to an arbitration clause whose validity is undisputed. The claimant alleged that he was in difficult economic-financial circumstances and unable to pay the costs of an arbitral tribunal, and was in fact litigating with legal aid (the full support option). The reply argued contempt for the arbitral tribunal but this was dismissed by the Braga Court which took the view that "*access to justice is a fundamental right that is superior to the right of the defendant (the unilateral right to demand arbitration)*". This decision was later upheld by the Guimarães Appeal Court and the Supreme Court of Justice, up to the Constitutional Court.

The ruling directly discusses the impossibility for one of the parties to finance the setting up and operating of the arbitral tribunal owing to inadequate financial resources – which came about after the arbitration clause was agreed. The question then is if in cases where this inadequacy is alleged, the right of access to justice (enshrined in Article 20 of the Constitution) makes compliance with the arbitration agreement untenable, which would result in the dismissal of the plea under Article 494(j) of the Civil Procedure Code (CPC). [3] [4]

The Court begins by acknowledging that there is no state monopoly on the administration of justice in the Portuguese legal order and Article 209(2) of the Portuguese Constitution (CRP) expressly provides for arbitral tribunals to which the parties may apply voluntarily, by means of an arbitration clause which creates legally binding effects on the parties thereto, and which carries guarantees of the effectiveness of the right itself (an expression of which is in fact subclause j) of the above-mentioned Article 494 of the CPC).

However, as legal aid is not foreseeable for arbitral tribunals, the Constitutional Court took the view that strict compliance with the content of the arbitration clause agreed by the parties would place the offending party in an "*untenable situation*".

1
Constitutional Court Ruling 311/2008, published in the official journal (*Diário da República, 2.ª série, n.º 148)* on 1 August 2008.

2
Ruling published in *Diário da República, 2.ª série, n.º 148* on 1 August 2008.

3
Although the Constitutional Court Ruling was the first to weigh up the constitutionality of Article 494(j) of the CPC, this issue and problem are not entirely unknown to Portuguese doctrine and jurisprudence. See particularly Constitutional Court Ruling 25/2001 (*Diário da República, 2.ª série, n.º 130*, of 4 June 2001), as well as Supreme Court of Justice Rulings of 18 January 2000 and 9 October 2003 (respectively in BMJ, no. 493 (2000), pp. 327 *et sq.*and at www.dgsi.pt (Case No. 03B1604 – Pires da Rosa)), and Lisbon Appeal Court Rulings of 5 June 2001 and 17 January 2006 (respectively in the Court Reports (*Colectânea de Jurisprudência*) 2001, Vol. III, pp. 110 *et seq.* and 2006, Vol. I, pp. 78 *et seq.*

4
For doctrine specific to this issue, see Joaquim Shearman de Macedo, "Sobre a Qualificação Civil da Incapacidade de Suportar os Custos do Processo Arbitral por uma das Partes", September 2008, to be published in the Themis magazine of the Universidade Nova de Lisboa Faculty of Law.

Now this conflict of rights entails a choice: either the arbitration clause is honoured (which may lead to one of the parties being denied justice) or the effectiveness of the clause which was freely agreed between the parties is denied and the court is deemed to have jurisdiction.

The Constitutional Court opted for the second alternative as it took the view that the interest sacrificed by excluding the arbitral tribunal is purely instrumental in nature because it only concerns the exclusion of a preferred method of appreciating and settling a dispute, which does not take the material circumstances of the parties into account.

Moreover, the Court further pointed out that the opposite solution, entailing the whole and definitive loss of the right to have a legal claim appreciated by a court, would result in an absolute lack of protection for the legal position claimed, with direct and particularly damaging impact on a primary value of the rule of law – the right of access to justice, which is afforded to all.

Within the limited scope of this article, we believe attention should be called to the following aspects:

The Constitutional Court Ruling turned on a dispute involving only national entities and where only Portuguese law was in question. However, the doctrine it establishes will also apply to international arbitration, where doubts may be raised as to the reasonableness of the arguments. In such cases, the option to go to arbitration is rarely an innocent one: it is a clear option by the parties not to submit to the courts of either. There are bound to be cases where questions may be raised as to whether the Party who concluded an arbitration clause would have done so (in the same terms) if he had thought arbitration would not take place.

Secondly, it should be stated that the scope of this decision is somewhat limited in application because, since 1 January 2008, profit-making companies and individual limited liability establishments no longer have the right to legal protection, whether legal counsel or legal aid[5]. Only individuals and non profit-making association will reap the benefits of this decision.

However, if it is the right of access to justice that justifies the declaration of unconstitutionality under discussion here, it begs the question why such a judgment is not also extendible to the parliament's decision simply to deprive companies of legal aid.

Moreover, it should also be asked to what extent it is legitimate to sacrifice the interests of the other party when he was the one to trigger the arbitration process.

Finally, despite the soundness of the arguments of all the courts who have appreciated this issue, it must be wondered to what extent it is acceptable to settle any and all disputes arising in this matter to the detriment of private independence. What is certain is that the Constitutional Court was careful to create two requirements: (i) the supervening nature of the financial hardship and (ii) the hardship must be attributable to the other party.

However, in view of the mechanics of the Portuguese process, the mere allegation of these two prerequisites will in principle be enough for the court to consider itself legitimised to decide on the merits.

Thus, despite the limited future scope of application of this decision, it is believed that it has not put a definitive end to the arguments as to the relevance of financial hardship.[5]

5
Article 7(3) of Law 34/2004 of 29 July, as amended by Law 47/2007 of 28 August.

Arbitration and Eviction Proceedings

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The Lisbon Appeal Court in its Ruling of 5 June 2007[1] [2] decided that:

> *"V – In order for the dilatory objection of disregard of arbitration clause to proceed, it is sufficient to allege and prove to the court that there is an arbitration clause which is not obviously void or ineffective and which is capable only of binding the parties in the dispute and encompassing this dispute within its range. VI – Disputes related to housing rentals may, in principle, be submitted to arbitration."*

Without going into the facts of the case, the aim was to evict a lessee, whon objected to the continuation of the proceedings alleging that an abirration clause had been disregarded. In his reply, the claimant argued that the arbitration clause was invalid as it dealt with matters outside the power of the parties, as article 63 of the RAU (Housing Rental Regime) required that the matter be settled by the courts.

On this point (the appeal contained other issues), the Court took the view that issues related to the validity, effectiveness and applicability of the arbitration clause were all extraneous to the decision by the courts. In light of the above, the Court referred to the principle of *kompetenz-kompetenz*, according to which arbitral tribunals have jurisdiction to rule on their own jurisdiction, and went even further deciding that besides attributing jurisdiction to the arbitral tribunals to rule on their own jurisdiction (positive effect), the principle also imposed a duty on the courts to refrain from making a decision without the arbitrators having previously ruled on their jurisdiction (negative effect).[3]

1
Strictly speaking this decision falls outside the scope of this Newsletter, in view of the date on which it was decided, but we have included it on account of its relevance.

2
At DGSI, File No. 1380/2007-1.

3
According to the Court the only exception – in accordance with article 12, number 5, of the RAU (Housing Rental Regime) – shall be the one when the Court decides that the arbitral convention is clearly void, when called to appoint an arbitrator, then refusing the appointment and paralysing the process.

In other words, the court will send the parties to arbitration if there is evidence of the existence of an arbitration clause.

Despite the abovementioned conclusions, the Court went a little bit further discussing the relevance of arbitration in lease dispute cases.

Therefore it began by stating that rental issues are not concerned with the parties' inalienable rights, thus excluding previous case law that supported this view. [4]

Nevertheless after having considered the issue, the Appeal Court upheld the jurisdiction of arbitral tribunals to hear cases involving the termination of the contract by the landlord.

It is well known that according to article 63(2) of the Housing Rental Regime[5] *"The termination of the rental agreement on the grounds of breach by the tenant shall be ordered by the court"*. However, along the same line of thought as PINTO FURTADO,[6] the court took the view that this does not mean that the termination must be declared in a judicial court action, only that it cannot be extra-judicially declared, as opposed to cases of termination by the tenant.

Whether or not we agree with the positions taken in this ruling, it is undoubtedly a landmark decision for arbitration autonomy, demonstrating a clear concern to limit court intervention in matters which the parties decided would be settled through arbitration.

As to the first of these aspects – scope of jurisdiction of the arbitral tribunal to decide on its own jurisdiction and its consequences – the proposition upheld by the court must be lauded for its similarity to what is commonly upheld today by international doctrine.

Moreover, such a view does not impact adversely on the rights of the parties, as an appeal will always lie from the arbitration decision on the ground of the tribunal's lack of jurisdiction[7] .

As regards the second issue – whether disputes about rental agreement terminations may be submitted to arbitration – although we agree at a legislative policy level that this is the right path to follow, we are in some doubt as to the compatibility of this view with articles 55 and 56 of the Housing Rental Regime[8]. In fact, the specific nature of the provision as to the course of the eviction action[9] points to the lawmakers having intended it to be presented in the courts.

This is an issue that is likely to resurface and one which will be worth following closely.

4
Lisbon Appeal Court Ruling of 23.10.2003 in File No. 3317/2003-6 (at DGSI).

5
This was the applicable legislation for the situation in the records.Article 1047 of the Civil Code provides today that *"The termination of the rental agreement shall be ordered by the court or extra-judicially declared"*, which leaves the problem open as article 1048 still expressly refers to bringing an «ordinary claim» against the lessee

6
Whose *Manual do Arrendamento Urbano* (3rd ed., 2001, p. 1051 and 1052) is widely quoted in the ruling.

7
The only situation with no immediate solution is the one where the arbitral tribunal believes it does not have jurisdiction and subsequently the court also rules to this effect, and in such case there will be an actual negative conflict.

8
Or today, in view of article 14 of Law 6/2006 of 27 February (which enacted the NRAU [New Housing Rental Regime]).

9
Any other understanding would entail accepting that the arbitration proceedings would have to follow the course of the ordinary claim, which would be a contradiction in terms.

The Year in Review

In 2008, PLMJ was again involved in various arbitration-related events:

Throughout the year:

-José Miguel Júdice was the only Portuguese speaker at the 1st Spanish and Portuguese Advanced Training Programme (PIDA) held by the ICC in Paris in June, where one of the students also belonged to this office.

-We were actively involved in the 1st post-graduate course in Arbitration held by UNL (Universidade nova de Lisboa), where José Miguel Júdice and Pedro Metello de Nápoles lectured in two of the modules and where five of the post-graduates also belonged to this office.

-Taking the opportunity of the meetings of the Portuguese Chapter of the *Club Español del Arbitraje*, debates on arbitration practice were organised- three have taken place already and this initiative is set to continue in 2009.

-The Annual General Meeting of the APA – Portuguese Arbitration Association - was held in October. José Miguel Júdice was elected to the new board and Pedro Metello de Nápoles was elected Executive Secretary.

We also attended the following events:

January - Young International Arbitration Group (YIAG) Symposium (LCIA), New York

February - 11th IBA Arbitration Day, New York

-LCIA Council Symposium

March - 1st encounter held by the Arbitration Proceedings Council of the APA-Portuguese Arbitration Association, Lisbon

April - II Congreso Peruano Internacional de Arbitraje, Lima

June - ICCA Conference, Dublin

- 3rd Congress of the Club Español del Arbitraje, Madrid

July - Congress of the Commercial Arbitration Centre of the Lisbon Commercial Association (of which José Miguel Júdice is Vice-President in charge of the arbitration section and at which he was a speaker)

September - Congress of the Brazilian Arbitration Committee, San Paulo

Outober - Seminar of the Portuguese Chapter of the Club Español del Arbitraje, Lisbon (presided over by José Miguel Júdice, who was a speaker)

- IBA Annual Conference, Buenos Aires

November - Cour Européenne d'Arbitrage Congress, Valência (where José Miguel Júdice was a speaker)

- II Arbitration Practice Day at APA, Lisbon