Neutral Citation Number: [2016] EWCA Civ 1267

Case No: A3/2016/1781, 1782, 1783 & 1785

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION, COMMERCIAL COURT
MR JUSTICE BLAIR

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 13/12/2016

Before:

SIR TERENCE ETHERTON, MR
LORD JUSTICE LONGMORE
and
SIR MARTIN MOORE-BICK

- -

Between:

BANCO SANTANDER TOTTA SA	**Respondent/ Claimant**
- and -	
COMPANHIA CARRIS DE FERRO DE LISBOA SA & ORS	**Appellants/ Defendants**

- -
- -

Ali Malek QC, Richard Brent and Kate Holderness (instructed by **Lipman Karas LLP**) for the **Appellants**
Laurence Rabinowitz QC, John Odgers QC and Simon Colton (instructed by **Slaughter and May**) for the **Respondent**

Hearing dates: 01 & 02 November 2016

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Approved Judgment

Sir Terence Etherton, MR:

1. This appeal relates to seven interest rate swaps (out of a total of nine) entered into between the appellants, Portuguese public sector transport companies ("the TCs"), and the respondent, a Portuguese bank ("Santander"), under ISDA Master Agreements subject to English law and jurisdiction ("the Swaps"). The appeal concerns the proper meaning of Article 3(3) of the Convention on the Law Applicable to Contractual Obligations 1980 ("the Rome Convention") and its application, if any, to Article 437 of the Portuguese Civil Code ("Article 437").

2. The appeal is from an order of Mr Justice Blair dated 24 March 2016, sitting as a judge of the Financial List, by which, among other things, he declared that the appellants' obligations under the respective Swaps are legal, valid and binding obligations enforceable in accordance with the terms of the respective Swaps.

3. This was the first case to be heard in the Financial List, which is a specialist List established in the Rolls Building in London on 1 October 2015 to handle claims related to the financial markets. This appeal is the first appeal from the Financial List.

The factual background

4. The full factual background to the proceedings, set out at length in the judgment of the Judge, is complex. The following is a very brief summary sufficient to understand the context of this appeal.

5. Santander is a member of the Banco Santander group. Between June 2005 and November 2007 it entered into the Swaps with the TCs, which run the metro, bus and tram services in Lisbon and in Porto, Portugal.

6. The Swaps are long-term interest rate swaps, under which Santander was (with one exception) the floating rate payer and the TCs were the fixed rate payers. An unusual feature of the Swaps was that once the reference interest rates (EURIBOR and sometimes LIBOR) moved outside upper or lower "barriers", the fixed rate payable by the TCs had a "spread" added to it. The spread was cumulative at each payment date and was subject to leverage: hence the Swaps being described as "snowball" swaps.

7. The Swaps initially provided positive cash flows for the TCs. The consequence, however, of sustained near zero interest rates since 2009 and the "snowball" structure of the Swaps is that the interest rates payable under the Swaps have increased very substantially. An agreed table of interest rates payable as at 21 October 2016 under the Swaps shows interest rates of between just under 30% to over 92%. Furthermore, by 1 October 2015 the mark-to-market value of the Swaps had become negative in an amount in excess of €1.3 billion.

8. The TCs ceased to make payments under the Swaps in 2013.

The proceedings

9. Santander commenced these proceedings for declarations that the TCs' obligations under the Swaps constitute legal, valid and binding obligations, enforceable in accordance with their respective terms, together with an order for payment of the

sums due or equivalent damages. The total amount claimed by Santander to be due as at 1 October 2015 was €272,561,157. That figure was not disputed.

10. The TCs advanced the following defences. First, under Portuguese law each of the TCs lacked capacity to enter the Swaps which are therefore void. Secondly, the effect of Article 3(3) of the Rome Convention is that, even though the ISDA Master Agreements specified that they were governed by English law, certain mandatory rules of Portuguese law apply, under which (1) the Swaps are void for being unlawful "games of chance" or speculations, and (2) they are liable to be terminated under Article 437 due to abnormal change of circumstances since the Swaps were entered into. Thirdly, Santander was in breach of its duties under the Portuguese Securities Code, entitling the TCs to damages which extinguish their liabilities under the Swaps.

The Rome Convention

11. The following provisions of the Rome Convention are particularly relevant to the appeal.

> "Article 1
>
> Scope of the Convention
>
> 1. The rules of this Convention shall apply to contractual obligations in any situation involving a choice between the laws of different countries. …"
>
> "Article 3
>
> Freedom of choice
>
> 1. A contract shall be governed by the law chosen by the parties. The choice must be expressed or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or a part only of the contract.
>
> 2. The parties may at any time agree to subject the contract to a law other than that which previously governed it, whether as a result of an earlier choice under this Article or of other provisions of this Convention. Any variation by the parties of the law to be applied made after the conclusion of the contract shall not prejudice its formal validity under Article 9 or adversely affect the rights of third parties.
>
> 3. 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`. …"

> "Article 4
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> Applicable law in the absence of choice
>
> 1. To the extent that the law applicable to the contract has not been chosen in accordance with Article 3, the contract shall be governed by the law of the country with which it is most closely connected. Nevertheless, a separable part of the contract which has a closer connection with another country may by way of exception be governed by the law of that other country.
>
> 2. Subject to the provisions of paragraph 5 of this Article, it shall be presumed that the contract is most closely connected with the country where the party who is to effect the performance which is characteristic of the contract has, at the time of conclusion of the contract, his habitual residence, or, in the case of a body corporate or unincorporate, its central administration. However, if the contract is entered into in the course of that party's trade or profession, that country shall be the country in which the principal place of business is situated or, where under the terms of the contract the performance is to be effected through a place of business other than the principal place of business, the country in which that other place of business is situated.
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> ….
>
> 5. Paragraph 2 shall not apply if the characteristic performance cannot be determined, and the presumptions in paragraphs 2, 3 and 4 shall be disregarded if it appears from the circumstances as a whole that the contract is more closely connected with another country."

12. Article 5 concerning certain consumer contracts and Article 6 concerning employment contracts provide for specified laws to apply, notwithstanding the provisions of Article 3, for the protection of the consumer and the employee respectively. Article 7 also provides for the mandatory rules of a country, with which the situation has a close connection or which is the forum, to be applied notwithstanding it is not the law that would otherwise be applicable under the Rome Convention.

13. The Rome Convention was (subject to certain exceptions) given effect in the law of the United Kingdom by the Contracts (Applicable Law) Act 1990 s.2. Section 3(1) of the 1990 Act provided that any question as to the meaning or effect of any provisions of the Convention shall be determined in accordance with the principles laid down by, and any relevant decision of, the European Court ("the CJEU"). Section 3(3) provided that the report on the Rome Convention by Professor Mario Giuliano and Professor Paul Lagarde ("the Giuliano-Lagarde Report") may be considered in ascertaining the meaning or effect of any provision of the Rome Convention.

14. It is common ground that the Rome Convention was adopted as part of the then European Community's programme to establish uniform rules across the Community

in the field of private international law, and was intended to be complementary to the Brussels Convention. It is also common ground that, like any other international treaty and EU legal instrument, it is to be interpreted adopting a purposive approach.

15. The Rome Convention was replaced by Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations ("Rome 1"), which came into effect on 17 December 2009. The Rome Convention applies to the Swaps because they were all concluded before that date.

16. There is continuity in some respects between the Rome Convention and Rome 1, including, in particular, Articles 1(1) and 3(3) of the Rome Convention and Rome 1 respectively. Recital (15) of Rome 1 states expressly that (even though the wording of Article 3(3) of Rome 1 is different) no substantial change was intended compared with Article 3(3) of the Rome Convention. This is why the Judge in his judgment and the parties in their submissions before us have made references to Rome 1.

17. We were referred to a great many scholarly commentaries on the Rome Convention and Rome 1. Particular sentences or larger passages were relied upon by each side. While all the distinguished authors are deserving of respect, I do not feel that the many references to these works have materially assisted the resolution of this appeal. On the other hand, it seems reasonable to take particular note of the published observations of the authors of the Giuliano-Lagarde Report and of others who participated in the preparation of the draft of the Rome Convention.

Article 437

18. Article 437 is as follows:

> "437 Abnormal change in circumstances
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> 1. If the circumstances on which the parties based their decision to enter into a contract have undergone an abnormal change, the injured party is entitled to termination of the contract or to modify it in accordance with principles of equity if fulfilment of that party's obligations under the contract would be a serious breach of the principles of good faith and if the abnormal changes do not form part of the risks covered by the contract.
>
> 2. If termination is requested, the counterparty may oppose by stating that it accepts modification of the contract in accordance with the previous paragraph."

The judgment of Mr Justice Blair

19. The Judge handed down a remarkably conscientious, clear and detailed judgment. It runs to 163 pages (including an annex) and 757 paragraphs. It is impossible to do it adequate justice in a brief summary.

20. For the purpose of my judgment, it is sufficient to state here the Judge's conclusions rather than his detailed analysis.

21. The Judge rejected all the defences. In relation to Article 3(3) he rejected the argument of the TCs that, on the proper interpretation of that provision, the only "elements relevant to the situation" are those which connect the contract to a particular country in a conflict of laws sense. He accepted the opposing argument of Santander that relevant elements include matters which point to the situation having an international character rather than a purely domestic one. He concluded that "all the other elements relevant to the situation" in the case of the Swaps were not connected only with Portugal since they included several which pointed to an international situation. His conclusion on this aspect was stated as follows in paragraph [411] of his judgment:

> "Summarising the main points made above, because of the right to assign to a bank outside Portugal, the use of standard international documentation, the practical necessity for the relationship with a bank outside Portugal, the international nature of the swaps market in which the contracts were concluded, and the fact that back-to-back contracts were concluded with a bank outside Portugal in circumstances in which such hedging arrangements are routine, the court's conclusion is that Art. 3(3) of the Rome Convention is not engaged because all the elements relevant to the situation at the time of the choice were not connected with Portugal only. In short, these were not purely domestic contracts. Any other conclusion, the court believes, would undermine legal certainty."

22. In the light of that conclusion the question whether Article 437 was a "mandatory rule" within Article 3(3), as a provision which cannot be derogated from by contract, did not arise. The Judge nevertheless expressed his view on the point since it had been fully argued.

23. The Judge concluded that Article 437 is not a rule of law which "cannot be derogated from by contract" and so a "mandatory rule" within Article 3(3) of the Rome Convention because, under Portuguese law, it can be waived by agreement of the parties after circumstances have arisen which allow one or other of the parties to rely on it. He said as follows at paragraph [506]:

> "It is sufficient to take a rule out of Art. 3(3) of the Rome Convention, in the court's judgment, if the rule can be disapplied by agreement between the parties whether *ex ante* or *ex post*. To take the present case, this distinguishes Art. 437 of the Civil Code, which deals with change of circumstances, from Art. 1245, which invalidates gaming and betting contracts. BST accepts that this is mandatory. Plainly, parties cannot contract out of rules applicable to gaming and betting contracts in any circumstances."

The appeal

24. The TCs have not appealed the Judge's rejection of their defences that they lacked capacity, that the Swaps were entered into in breach of Portuguese securities law, and

that the Swaps were void as unlawful games of chance. The appeal is confined to the issue whether, on the proper interpretation of Article 3(3), the Swaps are liable to termination or modification pursuant to Article 437.

25. There are four grounds of appeal, as follows.

> (1) The Judge was wrong to hold that, in determining whether, choice of law aside, all the other elements relevant to the situation are connected with one country only for the purposes of Article 3(3), the enquiry is not limited to elements that are local to another country, but includes elements that point directly away from a purely domestic to an international situation. He should have concluded that the enquiry (choice of law and jurisdiction aside) is concerned with whether all the other elements relevant to the situation are connected with more than one country or otherwise are such as to fall within conflict of laws principles. Had he done so, he would and should have concluded that all those elements at the time of the parties' choice of law were located in a single country, namely Portugal.
>
> (2) Alternatively, when applying Article 3(3) the Judge wrongly took into account and gave weight to the following matters: (a) the provision in the Schedule to the ISDA Master Agreements that provided that Santander may assign and delegate its rights and obligations under any Transaction (as defined) to any subsidiary of Banco Santander Hispano SA ("Santander Spain"); (b) the use of standard form documentation, in particular the use of the "Multicurrency Cross-Border" form of the 1992 ISDA Master Agreement; (c) the practical necessity for the relationship of Santander with a bank outside Portugal; (d) the alleged international nature of the swaps market in which the contracts were concluded; (e) the back-to-back contracts between Santander Spain and BSNP, a Portuguese bank, with which Santander contracted back-to-back swaps contracts.
>
> Had the Judge taken into account only admissible matters and given proper weight to the matters he identified, he would and should have concluded that none points "directly" to an international situation for the purposes of Article 3(3). He therefore would and should have concluded that all of the other elements relevant to the situation (other than the choice of law and jurisdiction) within Article 3(3) were located in Portugal.
>
> (3) Further, the Judge misconstrued Article 3(3) in holding that it is sufficient to take a rule out of Article 3(3) if the rights under the rule can be disapplied by agreement between the parties *ex post*. He should have concluded that whether a rule of law is one "which cannot be derogated from by contract" within Article 3(3) is to be addressed when the choice of law is made, i.e. *ex ante*.
>
> (4) In the light of grounds of appeal (1) to (3), the Judge would and should have concluded that Article 437 applied to the Swaps which should be terminated, subject to the court exercising its powers to modify their terms.

26. The notices of appeal include an application to the court to make a reference to the CJEU on the points raised in Grounds (1), (2) and (3) of the appeal.

27. Santander has served respondent's notices for upholding the Judge's order on the following additional grounds.

> (1) The Judge should have accepted (and wrongly rejected) the following two matters as relevant elements of the situation within Article 3(3): the use of international reference rates in the Swaps, namely EURIBOR and LIBOR, and the fact that the underlying obligations of the TCs, to which some of the Swaps were connected, were obligations concluded with third parties located outside Portugal.
>
> (2) Further, even if, contrary to the holding of the Judge, relevant elements of the situation within Article 3(3) are restricted to elements local to another specifically identifiable country, the following elements did point to a specific country outside Portugal: (1) the fact that, in respect of all the Swaps, the terms of the Swaps reflected back-to-back contracts concluded with Santander Spain, and that, but for the involvement of Santander Spain in the process, the Swaps would not have been concluded; (2) the fact that the underlying obligations of the TCs, to which three of the Swaps were connected, were loans from the European Investment Bank, seated in Luxembourg; and (3) the fact that the underlying obligation to which another of the Swaps was connected was a sub-sublease agreement with a Dutch company.
>
> (3) If, contrary to the view of the Judge, it was not sufficient to establish that the rule in Article 437 is non-mandatory that the parties could agree *ex post* that neither would seek to invoke Article 437, the Judge should nevertheless have concluded that it was non-mandatory by reason of the parties' ability *ex ante* materially and substantially to derogate from the scope of its application by making specific provision for risk.

Discussion

Appeal Ground (1): meaning of "elements relevant to the situation"

28. The heart of the TCs' case on the proper interpretation of those words is that they are confined to objective elements which, in the absence of the express choice of law by the parties, would be relevant and determinative of the proper law applying conflict of laws principles, and so connections which are not specific to a particular legal system are irrelevant.

29. In his oral submissions Mr Ali Malek QC, for the TCs, advanced the following arguments in support of that proposition.

30. His starting point was that Article 3(3) has to be seen and interpreted within the scope of the Rome Convention as set out in Article 1(1) as follows:

> "The rules of this Convention shall apply to contractual obligations in any situation involving a choice between the laws of different countries".

31. He submitted that Article 1(1) is directed to conflict of laws situations, and Article 3(3) is, consistently with that provision, also directed to principles of conflict of laws. In the TCs' skeleton argument the presence of the word "situation" in both Article 1(1) and Article 3(3) is relied upon as showing the connection between them and that, in both cases, the "situation" must be a conflict of laws "situation" since the same word ought to be given a consistent meaning.

32. Mr Malek relied on the commentary on Article 1(1) in the Giuliano-Lagarde Report, where it is stressed that "the uniform rules [in the Rome Convention] apply only in situations involving a choice between the laws of different countries", that is to say "situations which involve one or more elements foreign to the internal social system of a country … thereby giving the legal systems of several countries claims to apply …[which] are precisely the situations in which the uniform rules are intended to apply".

33. Mr Malek also relied upon the 1955 Hague Convention on the Law Applicable to International Sales of Goods ("the Hague Convention"). He said that Article 1 of the Hague Convention was the inspiration behind Article 3(3). He referred to a statement to that effect by Professor Giuliano in "La Loi applicable aux contrats: problèmes choisis" (1977).

34. Article 1 of the Hague Convention provided that it applied to international sales of goods but that "the mere declaration of the parties, relative to the application of a law …, shall not be sufficient to confer upon a sale [such] international character …". Article 2 of the Hague Convention provided that a sale shall be governed by the domestic law of the country designated by the contracting parties. In the absence of any such designation, Articles 3 and 4 provide for the applicable law to be determined on specified objective criteria. Article 6 provided that in each of the contracting states, the application of the law determined by those Articles might be excluded on a ground of public policy.

35. The thrust of Mr Malek's submission was that, just as Article 1 of the Hague Convention ensured that the Hague Convention only applied to contracts which were objectively international in a conflict of laws sense, so the purpose of Article 3(3) of the Rome Convention was to ensure that contracts which are not objectively international in a conflict of laws sense, and fall within the Rome Convention only because of a choice of law by the parties, remain subject to the mandatory rules of what is objectively the proper law.

36. Mr Malek submitted that the Judge's emphasis on the centrality under the Rome Convention of the certainty provided by the parties' choice of law, particularly in relation to financial instruments, rather than on the scope of the Convention under Article 1(1) as applicable to conflict of laws situations and on the precedent of the Hague Convention, was wrong. He said that, contrary to the approach of the Judge, financial contracts are not given special treatment in the context of Article 3(3). He contrasted the position of such contracts with the express special treatment given in the Rome Convention to consumer contracts and contracts of employment.

37. On that aspect, the TCs rely upon the approach of Paul Walker J in *Dexia Crediop Spa v Commune di Prato* [2015] EWHC 1746 (Comm), in which he held that the fact that the standard ISDA form is designed to promote certainty does not make it an

"element in the situation" within Article 3(3) since, absent the express choice of law provision, it is not of itself connected to a particular country. Reliance was placed by Mr Malek on paragraph 211 of *Dexia* as follows.

> "To my mind, Prato is right to say that both these points are misconceived. As to the master agreement, it is true that it is an international standard form, but it does not follow from this that it is an "element in the situation" which is connected to a country other than Italy. It is of course designed to promote certainty, but that does not give it a connection to a country other than Italy. Nor does the significance and global nature of ISDA. Even if the standard form itself were shown to have a connection with another country, that would not in the present case be an "element relevant to the situation" as it existed at material times. Throughout the relevant period everything relevant to the use of the form happened in Italy. As to Dexia's decision in each case to choose a non-Italian counterparty for its back to back hedging swap, that does not appear to me to be an element relevant to the situation as between Prato and Dexia. Whether or not Dexia entered into a hedging swap is a matter for Dexia alone: to Prato it is immaterial. There was no contemplation that a non-Italian entity would take over obligations of either party. Dexia's choice to use a non-Italian counterparty is something which is completely external to "the situation" at the time that choice of law was agreed."

38. Mr Malek pointed out that Article 3(3) was the result of a compromise between different policy approaches. The nature of the compromise was clearly set out in the following commentary on Article 3(3) in the Giuliano-Lagarde Report:

> "8. Article 3(3) provides that the choice of a foreign law by the parties, whether or not accompanied by the choice of a foreign tribunal, shall not, where all other elements relevant to the situation at the time of the choice are connected with one country only, prejudice the application of the law of that country which cannot be derogated from by contract, hereinafter called 'mandatory rules'.
>
> This solution is the result of a compromise between two lines of argument which have been diligently pursued within the Group: the wish on the one hand of certain experts to limit the parties' freedom of choice embodied in this Article by means of a correcting factor specifying that the choice of a foreign law would be insufficient *per se* to permit the application of that law if the situation at the moment of choice did not involve another foreign element, and on the other the concern of other experts, notably the United Kingdom experts, that such a correcting factor would be too great an obstacle to the freedom of the parties in situations in which their choice appeared justified, made in good faith, and capable of serving interests worthy of protection. In particular these experts emphasized

> that departures from the principle of the parties' freedom of choice should be authorized only in exceptional circumstances such as the application of the mandatory rules of a law other than that chosen by the parties; they also gave several examples of cases in which the choice of a foreign law by the parties was fully justified although there was apparently no other foreign element in the situation.
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> The Group recognized that this concern was well founded, while maintaining the principle that the choice by the parties of a foreign law where all the other elements relevant to the situation at the time of the choice are connected with one country only shall not prejudice the application of the mandatory rules of the law of that country."

39. English conflict of laws jurisprudence was firmly in favour of the right of the parties to select the law of the contract, provided their intention was bona fide and legal: *Vita Food Products Inc v Unus Shipping Co Ltd* [1939] AC 277, 290 (PC). Mr Malek observed, however, that the outright opposition to what became Article 3(3) of Rome 1 (the comparable provision to Article 3(3) of the Rome Convention) by ISDA, the Financial Markets Law Commission (of whose working group the Judge was a member when in private practice) and other UK experts based on freedom of choice, good faith and certainty was rejected.

40. Mr Malek raised the following further general points in support of the TCs' approach to the proper interpretation of Article 3(3). He said that the application of Article 3(3) is likely to be rare, not because it is to be interpreted in a narrow way, but because it will be a rare case where the facts fall within its provisions. He said that Article 3(3) does not change the law governing the entire contract but is a limited exception to the parties' choice of law. He submitted that, whether one is looking at Article 3(3) or Articles 5, 6 and 7, there will necessarily be an element of uncertainty and that the search for "black letter law" certainty in such circumstances is spurious. As it was put in the TCs' skeleton argument, the Rome Convention itself recognises that the aim or purpose of certainty must yield in certain circumstances to competing principles. He submitted that what are relevant in the context of Article 3(3) are objective criteria rather than the subjective intention of the parties. Finally, by way of general observation, Mr Malek submitted that the search for any kind of "international" factor lacks principle because there is no rule for distinguishing between foreign elements which are too trivial to be taken into account and those which are not, and, on Santander's case, the application of Article 3(3) becomes a matter for the arbitrary discretion of the Judge hearing the case. Expressed in slightly different terms in the TCs' skeleton argument, it is said that the Judge's interpretation is unprincipled since it is impossible to know what elements can legitimately be taken into account, and that, in a globalised market, there is no scope or almost no scope for Article 3(3) to apply.

41. I do not accept those criticisms of the Judge's analysis.

42. Analysis of the different language versions of the Rome Convention and Rome 1, demonstrated in Santander's skeleton argument, shows that there is no consistency in the use of the word "situation" across those different language versions and as

between the Rome Convention and Rome 1. To take just one example, in the Italian version the word "*situazioni*" appears in Article 1(1) of the Rome Convention but not in Article 3(3). It is no longer used in Article 1(1) of Rome 1 but is used in Article 3(3). The TCs cannot, therefore, find any support in the presence of the word "situation" in both Article 1(1) and Article 3(3) of the English text of the Rome Convention.

43. There is no conflict between Article 1(1) of the Rome Convention and an interpretation of Article 3(3), consistent with the natural and ordinary meaning of its words, that "elements relevant to the situation" are not confined to factors connecting the contract to a particular country in a conflict of laws sense.

44. Article 3(1) sets out the primary rule for resolving the choice of law issue specified in Article 1(1), that is to say a situation involving a choice between the laws of different countries. That primary rule, or fundamental principle, is the parties' autonomy to choose the applicable law. Article 3(1) in this respect simply reaffirms the rule embodied in the private international law of all member states and most other countries: see Giuliano-Lagarde Report commentary on Article 3(1). It has been described as "the starting point" of the Rome Convention by Professor Sir Peter North, who was a member of the UK delegation to the working group that produced the draft of the Rome Convention: *Private International Law Problems in Common Law Jurisdictions* at page 126. That fundamental principle is itself a key feature of the objective of the Rome Convention to provide greater legal certainty as to the conflict of laws rules (an objective expressly stated in recital (16) of Rome 1).

45. I see no conflict between that characterisation of the ability of the parties themselves to specify the governing law of the contract and recital (11) of Rome 1, to which Mr Malek drew attention, and which provides that "[t]he parties' freedom to choose the applicable law should be one of the cornerstones of the system of conflict-of-laws rules in matters of contractual obligation." The fact that the Rome Convention and Rome 1 pursue a number of different policy objectives does not detract from the starting point of the parties' autonomy to choose the law of the contract.

46. I accept the Judge's analysis, and Santander's case, that Article 3(3) is properly to be approached as a limited exception to the policy or principle or starting point of party autonomy and, as such, it is to be construed narrowly.

47. That approach is supported by the case law. *United Antwerp Maritime Agencies (Unamar) NV v Navigation Maritime Bulgare* Case C-184/12 (17.10.2013), [2014] 1 All ER (Comm) 625, concerned the inter-relationship between Article 3 and Article 7(2) (concerning the overriding mandatory rules of the law of the forum) of the Rome Convention. The CJEU said as follows at paragraph 49 of its judgment:

> "49. Thus, to give full effect to the principle of the freedom of contract of the parties to a contract, which is the cornerstone of the Rome Convention, reiterated in the Rome I Regulation, it must be ensured that the choice freely made by the parties as regards the law applicable to their contractual relationship is respected in accordance with art 3(1) of the Rome Convention, so that the plea relating to the existence of a 'mandatory rule' within the meaning of the legislation of the member state

> concerned, as referred to in art 7(2) of that convention, must be interpreted strictly."

48. *Republik Griechenland (the Hellenic Republic) v Gregorios Nikiforidis* Case C-135/15 (18.10.2016), [2016] ECR EU:C:2016:774, concerned the interpretation of Article 9 of Rome 1 (overriding mandatory provisions regarded as crucial by a country for safeguarding its public interests). The Grand Chamber said as follows:

> "42. For the purposes of determining the precise scope of Article 9 of the Rome I Regulation, it should be noted that it is apparent from Article 3(1) thereof and, so far as concerns, more specifically, employment contracts, Article 8(1), that freedom of contract of the contracting parties as to the choice of the applicable law constitutes the general principle laid down by the Rome I Regulation.
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> 43. Article 9 of the Rome I Regulation derogates from that principle that the applicable law is to be freely chosen by the parties to the contract. As recital 37 of the regulation states, this exception has the purpose of enabling the court of the forum to take account of considerations of public interest in exceptional circumstances.
>
> 44. As a derogating measure, Article 9 of the Rome I Regulation must be interpreted strictly (see, by analogy, judgment of 17 October 2013, *Unamar*, C-184/12, EU:C:2013:663, paragraph 49).
>
> …
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> 46. Moreover, to permit the court of the forum to apply overriding mandatory provisions of the legal order of Member States other than those which are expressly referred to in Article 9(2) and (3) of the Rome I Regulation would be liable to jeopardise full achievement of the regulation's general objective, which, as stated in recital 16, is legal certainty in the European area of justice."

49. There is no difference in those respects between the objects and proper interpretation of the relevant provisions of Rome 1 and of the Rome Convention.

50. I accept the argument of Mr Laurence Rabinowitz QC, for Santander, that Article 3(2) is to be seen as reinforcement of the primary rule of party autonomy by providing that the parties can at any time agree to change the applicable law.

51. The TCs' interpretation of Article 3(3) provides a much wider exception to the fundamental principle of party autonomy encapsulated in Article 3(1) than that for which Santander contends and which the Judge found. The Judge's interpretation of Article 3(3), in accordance with Santander's case, gives effect to the fundamental

principle of party autonomy and the objective of certainty underlying the Rome Convention and is consistent with the actual wording of its provisions.

52. It is noteworthy, as observed by Mr Justice Cooke in *Caterpillar Financial Services Corporation v SNC Passion* [2004] EWHC 569 (Comm), [2004] 2 Lloyd's Rep 99, at [18] that Article 3(3) refers to elements "relevant to the situation", which is wider than "elements relevant to the contract".

53. If it had been intended that "elements relevant to the situation" in Article 3(3) should be confined to factors of a kind which connect the contract to a particular country for the purpose of identifying the proper law in the absence of an express choice, the drafter could have used the familiar and simple conflict of laws language of "close connection", which one finds in Article 4. The marked difference between the language of Article 3(3) and of Article 4(1) is striking and supports an interpretation of Article 3(3) in accordance with the natural and ordinary meaning of its words. That striking difference is also apparent from other language versions of the Convention, such as the French, Italian and Spanish versions.

54. Insofar as Paul Walker J in *Dexia* reached a different conclusion on the proper interpretation of Article 3(3), that is to say by confining "elements of the situation" to those with a connection to a particular country in a conflict of laws sense, I respectfully disagree with him. It is to be noted that in a subsequent judgment in the *Dexia* proceedings - [2016] EWHC 2824 (Comm) – Paul Walker J said (at [150]) that he was not taken to decisions and academic writing on Article 3 generally (although the TCs say that he was mistaken in his recollection).

55. I cannot see that reference to the Hague Convention, as in some sense an historic precedent for the Rome Convention, assists. Insofar as it was an inspiration merely because it provided the means for ascertaining the law applicable to a category of international contracts, it does not advance any understanding of the particular provisions of Article 3(3) of the Rome Convention. Similarly, the fact that the final paragraph of Article 1 of the Hague Convention provided that the mere declaration of the parties is not sufficient to make a sale of goods an international sale within that Convention is far removed from the particular issue of the meaning of Article 3(3).

56. The Judge's approach is consistent with the comments of Professor Allan Philip, who was a member of the Danish delegation to the working group that produced the draft of the Rome Convention, that "Article 3(3) relates only to situations which do not contain any international elements" and that "Article 3(3) provides that the choice of foreign law in a purely domestic situation shall, under no circumstances, prejudice the application of mandatory rules of the country to which the situation so to speak belongs": *Contract Conflicts, The EEC Convention on the Law Applicable to Contractual Obligations, A Comparative Study* (ed, North, 1982) Chpt 5 pp. 94 and 95.

57. For all those reasons, I would dismiss Ground (1) of the appeal. I agree with the Judge's conclusion (at paragraph [404]) that the enquiry under Article 3(3) includes elements that point directly from a purely domestic to an international situation. Expressing the same point in a different way, I accept Mr Rabinowitz's submission, that the only question under Article 3(3), so far as relevant to this part of the appeal, is whether the situation is purely domestic.

Appeal Ground (2): relevant elements

58. Ground (2) of the appeal attacks the Judge's evaluation of the elements to be taken into account under Article 3(3). The criticism is that, even on Santander's interpretation of Article 3(3), the Judge wrongly took into account the factors specified in Ground (2) as indicating that all the elements relevant to the situation at the time of the choice of law were not connected with Portugal only.

59. The Judge's summary on this aspect, which is attacked, is contained in paragraph [411] of his judgment (mirrored at paragraph [749]). That paragraph summarises a detailed analysis at paragraph [409(1)-(8)], which was as follows.

60. On the relevance and significance of the provision in the Schedule to the Master Agreements that Santander "may assign and delegate its rights and obligations under any Transaction to any subsidiary of [Santander Spain]", the Judge said as follows.

> "At the time of contracting the bank had potential payment obligations over the long term, and so a right to assign was an important provision. The Transport Companies themselves point out that Santander Spain has numerous direct and indirect subsidiaries, including in the EU, UK, South America, USA and elsewhere. The effect was, therefore, that at the time of contracting, the contract allowed for substitution of a non-Portuguese bank for the Portuguese bank. This, in the court's view, is not a *potential* element relevant to the situation, as the Transport Companies argue, but an *actual* element relevant at the material time. It does not follow that the only contracts that fall outside Art. 3(3) are those which are non-assignable—the right to assign may be of limited or no significance depending on context. The significance of the bank's right of assignment in the present context is that the parties envisaged that performance over the substantial period (averaging 14 or so years) that the swaps covered could be by a *non-Portuguese* bank. This is not in the court's estimation consistent with the contract being seen as purely domestic."

61. As to the use of the "Multicurrency-Cross Border" form of the 1992 ISDA Master Agreement, and the international nature of the swaps market in which the contracts were concluded, the Judge said (at paragraphs [397] and [409(6)]) that the Swaps were concluded in an international market for OTC (over the counter) interest rate derivatives. In response to the TCs' argument that Santander considered itself to be operating in a Portuguese market, the Judge observed (at paragraph [409(6)]) that the evidence showed that the market was an international one, and that international banks competed for the business.

62. He observed (at paragraph [399]) that it is significant that the "Multi-Cross Border" form of the 1992 ISDA Master Agreement was used rather than the "Local Currency-Single Jurisdiction" form.

63. In his analysis the Judge linked the international nature of the swaps market, the chain of back-to-back contracts on ISDA terms governed by English law which laid off

Santander's risk and stretched down to Santander Spain, and the reliance of Santander on Santander Spain in negotiating and concluding the Swaps. He said (at paragraph [400]) that the use of such standard ISDA international documentation provided an orderly contractual structure which, among other things, facilitated both hedging and restructuring, and that, although there was no evidence that the TCs were aware of the actual hedging arrangements in respect of the Swaps, such arrangements were entirely routine in this kind of transaction (as the evidence showed). Mr Malek accepted before us that it was foreseeable by the TCs, at the time the Swaps were entered into in the present case, that back-to-back transactions might be entered into by Santander.

64. The Judge referred (at paragraph [409(5)]) to the undisputed evidence that Santander did not have the capabilities to sell complex derivatives on its own, and was dependent on Santander Spain to price the Swaps, to calculate the credit risk exposure of the transactions and to hedge Santander's market risk through back-to-back swaps.

65. Mr Malek repeated before us many of the submissions on these points that were raised before the Judge. On the matters in the last paragraph, the TCs submitted both before the Judge and before us that they were all irrelevant in the context of Article 3(3) because they were unknown to the TCs. As I read the judgment, however, their significance was that they underscored the international nature of the swaps market, of which objectively the TCs were or should have been aware from the ISDA forms used, the assignment provisions in the Schedule to the Master Agreements, and the fact that hedging arrangements such as those used in the present case were entirely routine and foreseeable.

66. Mr Malek emphasised that the Swaps were between Portuguese parties, whose obligations were to be performed in Portugal. He pointed out that nobody in Spain was directly involved in the Swaps transactions or their negotiation, which were handled by the officers of Santander in Portugal; in any event it is often necessary in a financial transaction to rely on a third party outside the jurisdiction; the benefit of a contract is always assignable, no assignments have been made since the Swaps were entered into, and there was no evidence that any particular assignment was contemplated when the Swaps were entered into; the back-to-back contracts made by Santander were entered into with another Portuguese entity and on a principal to principal basis and were not identical in their terms; banks can hedge on a book basis as an alternative to back-to-back contracts; there was no evidence that the TCs were aware of the hedging arrangements and no reason for them to be concerned with such arrangements. He submitted that generally the matters relied upon by the Judge did not point unambiguously to an international situation and are equally compatible with the situation being purely domestic.

67. The Judge had to carry out an evaluative exercise when identifying "elements relevant to the situation" for the purposes of Article 3(3) and then assessing whether they were all connected with one country only. The Court should only interfere with that evaluation if there was an error of principle or it was plainly wrong. The Court should be particularly cautious of reaching such a conclusion in a case like the present, where the appeal is from an expert and specialist court, the Financial List. Mr Malek acknowledged in his oral submissions that the Judge fairly summarised the case for the TCs on this part of the case in paragraph [408] of his judgment. The Judge addressed the various points raised by the TCs as to relevance of the factors relied upon by Santander and whether such factors were connected only with Portugal. I

cannot see any error of principle by the Judge and I consider it is simply impossible to say that he was plainly wrong.

68. For those reasons I would dismiss Ground (2) of the appeal.

69. In the circumstances, it is not necessary to give separate consideration to Santander's respondent's notices insofar as they concern those aspects of the Judge's judgment to which Grounds (1) and (2) of the appeal relate.

Appeal Grounds (3) and (4): application of Article 3(3) to Portuguese Civil Code Article 437

70. Grounds (3) and (4) of the appeal do not arise. Having heard full and able arguments on those grounds, however, and since I agree with those grounds and reject the respondent's notices relating to this part of the appeal, I shall explain very briefly my reasoning and conclusion. We heard a considerable number of elaborate arguments on this issue, with citation of cases and many references to scholarly texts, the 2006 VAT Directive, hypothetical scenarios concerning the law of frustration of England and Wales and the Unfair Contract Terms Act 1977. At the end of the day, however, this is a short and uncomplicated point.

71. The Judge accepted (at paragraph [522]) the evidence of Professor da Frada, the TCs' expert, that as a matter of Portuguese law the application of Article 437 can never be totally excluded on an *ex ante* basis. Professor da Frada accepted that the parties can make specific provision for risk on an *ex ante* basis but, on the Judge's findings, it is not possible under Portuguese law to exclude *ex ante* the application of Article 437 to any risks which have not been identified and provided for. The parties cannot, for example, agree in advance that, as regards any such unidentified risk, the applicable law shall be that of another jurisdiction or be dealt with in accordance with a set of rules different from Article 437. I can see no reason why, consistently with the purpose of Article 3(3) of the Rome Convention, that irreducible minimum mandatory application of Article 437, that is to say its non-derogable core, should not make it "non-derogable" (within the meaning of Article 3(3)) from an *ex ante* perspective.

72. That is consistent with the observation of Professor Philip that mandatory rules "are rules which the parties cannot derogate from by their agreement or from which they can only derogate within certain limits": *Contract Conflicts, The EEC Convention on the Law Applicable to Contractual Obligations, A Comparative Study* (ed, North, 1982) Chpt 5 p. 83.

73. Turning to the position *ex post*, I do not agree with the Judge that an *ex post* agreement not to rely on Article 437, following the occurrence of a particular risk, means that it is derogable for the purposes of Article 3(3). Derogation, in the context of Article 3(3) of the Rome Convention, involves a disapplication of the rule of law in question. An *ex post* waiver of a right to rely on Article 437 is not a disapplication. It is simply a voluntary refusal to enforce rights which have arisen.

74. This analysis of the words "which cannot be derogated from by contract" in Article 3(3) of the Rome Convention (matching the words "which cannot be derogated from by agreement" in Article 3(3) of Rome 1) is consistent with, and supported by, recital (37) of Rome 1. That recital states that the concept of "overriding mandatory

provisions" (Article 9 of Rome 1, corresponding to Article 7 of the Rome Convention) should be distinguished from the expression "provisions which cannot be derogated from by agreement" "and should be construed more restrictively".

75. There is no appeal against the Judge's finding (in paragraph [637]) that requiring the TCs to perform their obligations under the Swaps, obliging them alone to bear the burden of the adverse effect of the general financial crisis on interest rates, resulting in a financial imbalance between the parties to the Swaps and adversely affecting the equilibrium of the contracts, would be a serious breach of the principles of good faith within the meaning of Article 437. Accordingly, if Portuguese law had applied to the Swaps, the TCs would have succeeded in their case that the requirements of Article 437 are satisfied.

Conclusion

76. For all those reasons I would dismiss this appeal.

Reference

77. Article 2 of the First Protocol to the Rome Convention confers power to make a reference to the CJEU if the referring court considers that a decision on the question is necessary to enable it to give judgment. I consider that a reference is not necessary or otherwise appropriate in the present case because the proper interpretation of the words "all the other elements relevant to the situation … are connected with one country only" is clear.

Lord Justice Longmore:

78. I agree with the Master of the Rolls that this appeal should be dismissed for the reasons which he gives.

79. I would, however, sound a note of caution about issue (3) since I think there is something to be said for the view that a force majeure provision of a national law (such as Article 437) is not necessarily a provision which is non-derogable within the terms of Article 3(3) of the Rome Convention. It effectively fills a gap which the parties have left unexpressed in their agreement; if filling every such gap is to be regarded as non-derogable provision, that would mean that much of a country's contract law would have to be regarded as non-derogable. That may indeed be the case but I would prefer to leave the matter undetermined until a case arises which truly raises the point as an essential matter for decision.

80. It might be said that it is only the reference to the element of good faith in Article 437 which makes the provision non-derogable and good faith is not an element of every gap-filling exercise in the law of contract. But since good faith underlies many provisions of the law of contract of countries other than that of England and Wales, that would still leave a large part of such other countries' contract law which would be regarded as non-derogable.

81. While therefore I agree with the Master of the Rolls that the Judge's reasons for holding Article 437 to be non-derogable were wrong, there may be more to be said for his actual decision on non-derogability, if not for his reasons.

Sir Martin Moore-Bick:

82. I agree that this appeal should be dismissed for the reasons given by the Master of the Rolls.