PENALTIES, PUBLIC POLICY AND THE ENFORCEMENT OF ARBITRATION AWARDS

In *Pencil Hill Ltd v US Citta Di Palermo SPA* [2016] QBD (unreported) the High Court held that it would not be contrary to public policy to enforce an arbitration award which included an award in respect of a penalty. The key practical point is that New York Convention awards may be enforceable in England even though they give effect to obligations which English law would consider to be unenforceable penalties.

The case is also a good example of the "pro arbitration" stance of the English courts. In this jurisdiction, the enforcement of arbitration awards will generally only be refused on public policy grounds where there is some element of illegality or where enforcement would be "injurious to the public good".

BACKGROUND

In 2012 the claimant (Pencil Hill) sold the registration rights of a football player to the defendant, an Italian football club (Palermo), for a total of €6,720,000 to be paid in two instalments (the Instalments). A further €1,000,000 became due under an additional agreement.

If Palermo failed to pay any part of the Instalments on time then the remaining amount would become due together with a penalty equal to that remaining amount, i.e. Palermo would have to pay double the remaining amount. The contract provided for all disputes to be submitted to the Court of Arbitration for Sport (the CAS) according to Swiss Private law.

Palermo failed to pay anything and the matter was referred to the CAS. Pencil Hill made a claim for €6,720,000 for the Instalments, a further €6,720,000 as a penalty payment and €1,000,000 for the amount due under the additional agreement.

The CAS awarded a total of €9,400,000. This included the €6,720,000 and €1,000,000 due under the two agreements but, applying Swiss law, the tribunal reduced the penalty to €1,680,000 (25 per cent of the amount claimed). In reaching their decision the CAS expressed the view that the original penalty of €6,720,000 was *"disproportionate and unfair"*.

JUDGMENT

The only issue before the High Court was whether to refuse the enforcement of €1,680,000 on the ground that to do so would be contrary to public policy.

The following factors led the High Court to conclude that enforcing the award would not be contrary to public policy:

1. the court should lean towards enforcing foreign arbitration awards;
2. there are only a narrow set of circumstances where a court can refuse to enforce such an award, one such ground is public policy;
3. the bar for refusing to enforce an award on the grounds of public policy is high; it would have to be "injurious to the public good";
4. in the current case the parties chose Swiss law as the governing law, and the award was made on this basis. This choice should be taken into account when reaching a decision; and
5. the CAS had reduced the amount payable to a level which, as a matter of Swiss law, was not penal.

COMMENT

The case should not be seen as a "green light" for parties to circumvent the English rules on penalty clauses simply by providing for their contracts to be governed by a foreign law and for disputes to be referred to arbitration. The outcome may have been different if England had been the place of performance of the underlying contract or if the penalty amount had not been reduced. However, the case does show that the English courts will not apply "domestic" concepts of public policy when considering whether to enforce New York Convention awards, and that the public policy of enforcing international arbitration awards outweighs the public policy of refusing to enforce penalty clauses (at least where local law provides its own protections against penalties).

It is not clear whether the same approach would be taken in the enforcement of foreign court judgments. In the case of *JSC VTB Bank v Pavel Valerjevich Skurikhin and others* [2014] EWHC 271 (Comm) the High Court refused, in the context of an application for summary judgment, to enforce a number of Russian judgments insofar as those judgments gave effect to penalties. However, as the point only arose on an application for summary judgment, the judge only had to consider whether it was arguable that the judgments should not be enforced and he did not reach a firm conclusion on the point.

Until this point is clarified, parties to contracts which are to be performed abroad, and which contain penalty provisions which are likely to be enforceable under the local law but unenforceable under English law, may be better off referring their disputes to arbitration so as to improve their prospects of success in any enforcement proceedings brought in this jurisdiction.

CONTACT DETAILS
If you would like further information or specific advice please contact:

GEOFF STEWARD
PARTNER
LITIGATION AND
DISPUTE RESOLUTION
DD +44 (0)20 7849 2341
geoff.steward@macfarlanes.com

EMILY ASHE
SOLICITOR
LITIGATION AND
DISPUTE RESOLUTION
DD +44 (0)20 7849 2970
emily.ashe@macfarlanes.com

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