

# The annulment of an arbitral award on the grounds of public policy in light of the judgment issued by the Constitutional Court on 15 June 2020

## THE ANNULMENT OF AN ARBITRAL AWARD ON THE GROUNDS OF PUBLIC POLICY IN LIGHT OF THE JUDGMENT ISSUED BY THE CONSTITUTIONAL COURT ON 15 JUNE 2020

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### A. INTRODUCTION TO THE ANNULMENT OF ARBITRAL AWARDS UNDER SPANISH LAW

1. The Spanish arbitration system is governed by Law 60/2003, of 23 December, on Arbitration (the “**Spanish Arbitration Act**”)<sup>3</sup>, which was later amended by Law 11/2011, of 20 May<sup>4</sup>. This regulation provides that when parties decide to submit their dispute to arbitration, judicial bodies are automatically precluded from hearing the case<sup>5</sup>. Consequently, the intervention of judicial bodies is limited only to control and support functions.

2. Among those functions, one of the most significant is the acknowledgement of the annulment of arbitral awards<sup>6</sup>. Prior to the amendment of the Spanish Arbitration Act, the annulment of arbitral awards was considered an appeal, under which it was possible to review the award in circumstances where the law or jurisprudence had been breached<sup>7</sup>.

3. However, currently, annulment is understood as an autonomous and extraordinary action, the only purpose of which is to review the validity of an award. In this regard, the Explanatory Memorandum of the Spanish Arbitration Act is very clear in its terms in stating that, as a general rule, annulment does not allow a review of the merits of an arbitral award<sup>8</sup>. For this reason, the grounds on which an award can be set aside are strictly set out in the Spanish Arbitration Act<sup>9</sup>. We will analyse these grounds further.

4. Once the arbitral award has been issued, the parties shall bring the annulment action before the High Courts of Justice (“**High Courts**”)<sup>10</sup> of the place where the award was made<sup>11</sup> and it must be filed within two months of the issuing of the award<sup>12</sup>.

5. The procedure for setting aside an arbitral award must be conducted in accordance with the rules of judicial proceedings and, in particular, with the rules of the oral proceedings<sup>13</sup>. The claimant and respondent must submit their respective pleadings and they may request a hearing in order to evaluate the proposed evidence.

6. The proceedings will be concluded by a judgment handed down by the High Courts to which no appeal shall be admitted. This judgment may uphold the claim for annulment in its entirety (the award will become

ineffective in its totality) or partially (those parts of the award that have not been affected by the reasons given for annulment will be declared valid)<sup>14</sup>. In contrast, if the court dismisses the annulment action, the award will become final.

7. As mentioned above, the grounds on which an award may be annulled are very limited. In particular, those grounds require that the parties are able to prove that: (a) the arbitration agreement does not exist or is invalid; (b) the applicant has not been duly notified of the appointment of an arbitrator or arbitral acts or that they have not been able, for any other reason, to enforce their rights; (c) the arbitrators have decided on matters which are not subject to their jurisdiction; (d) the appointment of the arbitrators or the arbitration procedure has not complied with the agreement between the parties, unless such agreement is contrary to a mandatory rule of the Spanish Arbitration Act, or, in the absence of such agreement, that they have not complied with the Spanish Arbitration Act; (e) the arbitrators have ruled on matters not subject to arbitration; or (f) the award is contrary to public policy.

8. The parties can invoke all of the aforementioned grounds for the annulment of an arbitral award. In addition, with regard to grounds (b), (e) and (f), these could also be examined by the High Courts of their own volition.

9. The purpose of this article is to acquaint the reader with recent events of the last few years, where, in some cases, some Spanish High Courts of Justice have annulled arbitral awards invoking the grounds of public policy.

## **B. PUBLIC POLICY AS ONE OF THE GROUNDS TO SET ASIDE AN ARBITRAL AWARD AND THE DIFFERENT INTERPRETATIONS OF THIS CONCEPT**

### **a) The meaning of public policy**

10. The concept of public policy is complex, and despite the fact that Spanish judicial authorities such as the Constitutional Court<sup>15</sup>, the Supreme Court<sup>16</sup>, the Courts of Appeal<sup>17</sup> and the High Courts have tried to define it, it still remains a legal dilemma, inaccurate and undefined<sup>18</sup>.

11. Broadly speaking, the concept of public policy involves fundamental rights, freedoms guaranteed by the constitution, inalienable principles to legislature and internationally recognised principles<sup>19</sup>.

12. In Spain, the concept of public policy has historically been interpreted in a restrictive way, where it is considered that public policy is breached only if there is a clear breach of fundamental rights or procedural guarantees. When High Courts have annulled an arbitral award (or rejected the recognition of an arbitral award) on the grounds of public policy, they have addressed two different senses of the concept of public policy: material and procedural.

13. In its material sense, the concept of public policy can be defined as a group of values and essential principles with constitutional significance, which are binding upon the legislature. As political, economic, moral and social principles, they constitute the legal framework that defines a State, at a certain time and in a specific historical context<sup>20</sup>.

14. From a procedural point of view, the concept of public policy embraces a set of formalities and essential principles of our procedural legal framework<sup>21</sup>. These are mainly expressed by the principles of hearing, the adversarial process, defence and equality.

15. On 28 January 2015 the Madrid High Court handed down a judgment introducing a new concept of public policy, the so-called economic public policy, which until then had not been mentioned to annul arbitral awards (the “**2015 Judgment**”).

16. The 2015 Judgment annulled an award made in relation to a SWAP agreement, on the grounds of public policy and, specifically, for the two following reasons: the breach of “economic public policy” and the absence of motivation of the arbitral award. We will now analyse those grounds.

#### **b) The concept of “economic public policy”**

17. Prior to analysing the Madrid High Court’s decision to annul the award, it is necessary to address some of the significant details of the arbitral case.

18. The arbitral case concerned an Interest Rate Swap contract (“**SWAP**”) signed between a consumer and a bank entity, where the consumer questioned the validity of the SWAP. The award issued by the arbitration court found that the contract was valid and that the bank entity had complied with the obligations of diligence, loyalty and information as required by the regulations of the Securities Market Law<sup>22</sup>.

19. In response to the award, the consumer sought the annulment of the award on two grounds based on Article 41.1.f) of the Spanish Arbitration Act: (i) the absence of impartiality on the part of the arbitral tribunal that issued the award; and (ii) the breach of economic public policy.

20. The Madrid High Court that heard these annulment proceedings concluded that in that case, the bank entity had not complied with the information duties required by the securities market regulations, and, specifically, the MiFID<sup>23</sup> regulations. The Madrid High Court stated that: (i) it had not carried out the mandatory consumer suitability test and; (ii) it had omitted relevant information on the costs and risks associated with the SWAP agreement, by erroneously considering the product as non-complex. For these reasons, the Madrid High Court annulled the award in question, finding that the award had breached economic public policy.

21. Until the 2015 Judgment, the aforementioned concept of economic public policy had only appeared in the ordinary jurisdiction. Specifically, this term arose in a dispute involving a challenge to corporate resolutions, in which the court of first instance and the Appeal Court had dismissed the challenge and absolved the defendant company. The claimant filed an appeal before the Supreme Court<sup>24</sup> arguing a breach of the law and economic public policy. The Supreme Court dismissed the appeal, although it took this opportunity to state that the concept of economic public policy is expressed through mandatory rules and basic principles of economic policy that are binding and limit the private autonomy of the parties<sup>25</sup>.

22. In the 2015 Judgment the Madrid High Court used the term “economic public policy” but in a different sense to that invoked by the Supreme Court. Specifically, the Madrid High Court defined “economic public policy” as any mandatory rules and basic principles that cannot be ignored in cases where special protection is required because the purpose of these mandatory rules is to guarantee the principle of good faith in transactions between financial institutions and consumers, as in the case considered in the 2015 Judgment.

23. As mentioned, the Madrid High Court found that some MiFID regulations applicable to consumers had been breached and, consequently, the arbitral award had to be annulled.

24. In this respect, the Madrid High Court stated that, as one of the parties in the case was a consumer, there were certain consumer regulations (such as MiFID) that, as mandatory regulations, are intended to ensure the principle of good faith in contracts. Hence, the breach of this principle is considered a matter of public policy

and, particularly, a matter of “economic public policy”<sup>26</sup> that affects the validity of the arbitral award.

25. This new interpretation by the Madrid High Court suggests that any mandatory rule is a matter of public policy. Consequently, it allows the tribunal to expand the operational field of the public policy concept (apart from the material and procedural concepts of public policy) and it expands the scope of annulling an arbitral award too<sup>27</sup>.

26. Part of the arbitral doctrine states that the interpretation made by the Madrid High Court takes the principle of good faith and considers that all those rules related to this principle must be understood as issues of “economic public policy”. The same part of the doctrine holds that the Madrid High Court is not entitled to replace the criteria of the award with others that could be considered more appropriate or fair to it<sup>28</sup>.

27. In addition, part of the criticism to the judgment of the Madrid High Court considers that it is highly questionable from a legal point of view that the breach of public policy means any breach of a legal provision, regardless of whether it is a mandatory provision or not, since not every breach of a mandatory rule is a matter of public policy<sup>29</sup>.

28. Finally, it is important to note that although the Madrid High Court has used the “economic public policy” ground since 2015 to annul arbitral awards, it has only been used to set aside arbitral awards concerning SWAP agreements where the Madrid High Court understands that one of the parties is a consumer<sup>30</sup>.

### **c) The absence of motivation of the arbitral award as a public policy issue**

29. In parallel to the ground of breach of “economic public policy”, as discussed above, the Madrid High Court also annulled the award related to the SWAP case on the grounds of the absence of motivation.

30. The arbitral award considered the SWAP agreement a non-complex financial product, the terms of which could be easily understood by the claimant (a consumer). The Madrid High Court held that the arbitral award, by defining the SWAP agreement in those terms and ignoring the risks and costs inherent to the SWAP agreement, was not sufficiently motivated. Consequently, the Madrid High Court considered that the lack of justification for the award amounted to a breach of public policy as it breached effective judicial protection<sup>31</sup>.

31. Under Spanish Law, the “arbitrariness control” carried out by the judicial bodies to review a judgment<sup>32</sup> is justified by the right of any person to receive a motivated ruling, which is an unquestionable expression of the right to effective judicial protection.

32. In this regard, through its 2015 Judgment, the Madrid High Court stated the “arbitrariness control” is applicable to judicial decisions to arbitral awards also. The Madrid High Court considered that it is entitled to control the arbitrariness of the award; insofar as arbitration is a “jurisdictional equivalent” as established by the Spanish Constitutional Court<sup>33</sup>.

33. Specifically, the Spanish Constitutional Court has stated on several occasions that the institution of arbitration is a “jurisdictional equivalent” through which the parties can reach the same goals as in judicial proceedings. In other words, through arbitration, the parties can get a resolution that puts the dispute to an end with all the effects of *res judicata*<sup>34</sup>.

34. The Madrid High Court considers that it is entitled to control the justification of the award and when this control is not fulfilled, as the effective judicial protection is damaged, there is a breach of public policy in its procedural sense and consequently, the award must be annulled.

35. Moreover, the Madrid High Court justifies its role of controlling the motivation of the award on a second ground. As the Spanish Arbitration Act prohibits non-motivated awards and removes the option for the parties to agree otherwise<sup>35</sup>, the High Court must ensure its compliance by carrying out an “arbitrariness control” of the arbitral award.

36. The Madrid High Court’s interpretation of the concept of “jurisdictional equivalent” has been questioned by part of the doctrine. It considers that when the Spanish Constitutional Court stated that arbitration is a “jurisdictional equivalent”, it only did so in terms of its effects, but in no way does this mean that arbitration and jurisdictional proceedings or the award and a judicial judgment could be the same thing<sup>36</sup>. Consequently, there is no reason why the “arbitrariness control”, which applies to revision of judgments, should also apply to arbitral awards.

37. This same part of the doctrine also considers that although the Spanish Arbitration Act prohibits the parties from agreeing to a non-motivated award, it does not prohibit them from deciding on the scope within which they want an award to be motivated. This means that, for example, the parties may agree that the proceedings should specify the reasons that led the arbitrators to make the decision in a particular way, but without the need to respond to each one of the allegations made by the parties. Hence, only an absence of justification or an absurd, unreasonable or incongruent justification would be a ground for the nullity of the arbitral award due to a breach of public policy<sup>37</sup>.

38. Despite all the criticism that has been expressed over the past few years regarding the Madrid High Court’s criteria, the Madrid High Court stands firm in its position. In fact, the Madrid High Court has maintained its position by also annulling awards that are not related to SWAP agreements.

39. In its recent judgment from 8 January 2020, the Madrid High Court once again stated that as long as arbitration is a “jurisdictional equivalent”, the arbitral award is also an equivalent of the judicial decision. Therefore, the “arbitrariness control” is also applicable to the arbitral award in order to guarantee, not only the rights of the parties but also the confidence of society and the reliability of judges and arbitrators<sup>38</sup>.

40. Finally, we must point out that the Madrid High Court’s criteria used to annul arbitral awards on the grounds of lack of motivation have not been followed by other High Courts in Spain, so it is an isolated position.

#### **d) The inability of judicial bodies to review the merits of an arbitral award**

41. The 2015 Judgment has been highly criticised for its interpretation of the concepts of “economic public policy” and the lack of motivation for the arbitral award. Additionally, the most significant criticism of the Madrid High Court’s criteria focuses on the fact that part of the doctrine considers that it is exceeding its authority when analysing the merits of the award.

42. As we have previously noted, the Explanatory Memorandum of the Spanish Arbitration Act is clear in its terms when stating that the annulment of an arbitral award enables the judicial bodies to review the validity of an award but as a “general rule”, not to analyse its merits. Additionally, annulment is not considered an appeal that allows unlimited revision of the factual judgment and the legal reasoning carried out by the arbitral tribunal<sup>39</sup>.

43. Considering that the Spanish Arbitration Act does not permit an analysis of the merits, it is important to understand how the concept “general rule” has been interpreted as a half-opened door to analyse the merits of an arbitral award under certain exceptions.

44. Even though the Madrid High Court has admitted that the general rule does not allow it to evaluate the merits of an arbitral award, through its recent judgment of 8 January 2020 it also considers that there is an enormous distance from that point of view to the exclusion of every analysis of the merits of an award<sup>40</sup>.

45. Finally, the Madrid High Court also pointed out that just as it is indisputable that in order to analyse whether the subject matter of a dispute is subject to arbitration or not, it is necessary to examine the merits of an award, in order to know whether an award breaches public policy, the same rule should apply. In other words, the Madrid High Court considers that in order to determine whether an award breaches public policy or not, it is necessary to be able to examine the merits of the award.

46. In contrast to the Madrid High Court's criteria, part of the doctrine holds that this High Court has misunderstood the exception to the general rule because the concept of public policy cannot be expanded to the point where it entitles the judicial bodies to analyse the merits of an arbitral award.

47. Over the last few years, this discussion has been raised to the Constitutional Court, through several appeals for constitutional protection<sup>41</sup>, on the grounds that the Madrid High Court was reviewing the merits of the award and it was beyond its jurisdiction. Currently, some of these appeals have been admitted and are still pending.

48. Recently the Spanish Constitutional Court has upheld one of them, which is related to an award that had been annulled by the Madrid High Court on the grounds of public policy.

### **C. THE RECENT JUDGMENT ISSUED BY THE SPANISH CONSTITUTIONAL COURT ON 15 JUNE 2020 AND COMING JUDGMENTS**

49. On 15 June 2020, the Spanish Constitutional Court handed down a judgment finding that the Madrid High Court had exceeded its powers by annulling an award through consideration of the merits of the award<sup>42</sup>.

50. The case on which the Spanish Constitutional Court ruled involved arbitration proceedings concerning unpaid rent. The case ended through an award, which ordered the tenant to pay that rent.

51. The tenant filed an annulment action of the arbitral award before the Madrid High Court claiming that the arbitration agreement governing the contract was abusive. Subsequently, while the annulment action was still pending, both parties reached an out-of-court settlement and consequently, they requested the Madrid High Court to terminate the proceedings.

52. The Madrid High Court rejected their petition stating that the procedure for setting aside an award was not available to the parties since there is a general interest in the control of those awards that may breach public policy<sup>43</sup>. In other words, the Madrid High Court held that when an award affects the public interest and goes beyond the interest of the parties themselves, the latter cannot dispose from the procedure.

53. Given this situation, the parties filed an appeal before the Spanish Constitutional Court arguing that the decision of the Madrid High Court infringed their free will.

54. The Spanish Constitutional Court has upheld the appeal in support of arbitration. In particular, the court held that there is no legal provision which prevents out-of-court settlements, and there are no grounds of public policy since that was a strictly economic matter only involving the parties and not affecting third parties<sup>44</sup>.

55. Although the Spanish Constitutional Court did not directly decide on the annulment of an arbitral award on

the grounds of public policy, it is noteworthy that it made specific reference to that concept and how it should be interpreted. In particular, the Spanish Constitutional Court has stated that the expansion of the concept of public policy in order to review the merits of the case, which is something that is essentially a matter for arbitrators, goes beyond the scope of annulment<sup>45</sup>.

56. Moreover, the Spanish Constitutional Court states that precisely because of the lack of precision of the concept of public policy, the annulment of an arbitral award cannot be used by the High Courts as an excuse to re-examine the merits of the case.

57. In summary, according to the recent judgment handed down by the Spanish Constitutional Court, the approach to this abstract concept of public policy could undermine the very nature of arbitration and the free will of the parties.

58. Although the problem has not been definitively resolved, the Constitutional Court has admitted other appeals related to awards annulled on the grounds of public policy by The Madrid High Court. Thus, we will see in the coming months if the Constitutional Court ratifies this approach in support of arbitration or not.

59. Similarly, it will be necessary to look at the reaction of the Madrid High Court to this recent judgment handed down by the Constitutional Court and, specifically, whether it changes its interpretation of the concept of public policy.

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[3] Ley 60/2003, de 23 de diciembre, de Arbitraje.

[4] Law 11/2011, of 20 May, amending Law 60/2003, of 23 December, on Arbitration and regulation of institutional arbitration in the General State Administration (Ley 11/2011, de 20 de mayo, de reforma de la Ley 60/2003, de 23 de diciembre, de Arbitraje y de regulación del arbitraje institucional en la Administración General del Estado).

[5] Supreme Court judgment 429/2009, of 22 June, Legal Ground 4<sup>o</sup> and Article 8 of the Spanish Arbitration Act.

[6] Article 40 of the Spanish Arbitration Act.

[7] Madrid High Court judgment 4/2020, of 8 January, Legal Ground 2<sup>o</sup>. a).

[8] Section 8 of the Explanatory Memorandum of the Spanish Arbitration Act.

[9] Article 41.1 of the Spanish Arbitration Act.

[10] *Tribunales Superiores de Justicia* translated as High Courts of Justice. Under Spanish Law, there is one

High Court of Justice for each of the Spanish autonomous communities.

[11] Article 8.5 of the Spanish Arbitration Act.

[12] Article 41.4 of the Spanish Arbitration Act.

[13] Article 42 of the Spanish Arbitration Act.

[14] Article 41.3 of the Spanish Arbitration Act.

[15] *Tribunal Constitucional*, translated as Constitutional Court.

[16] *Tribunal Supremo*, translated as Supreme Court.

[17] Audiencias Provinciales, translated as Courts of Appeal.

[18] FERNÁNDEZ ROZAS, J.C., “*Contravención al orden público como motivo de anulación del laudo arbitral en la reciente jurisprudencia española*”, *Revista de Arbitraje Comercial y de Inversiones*, 2015; con expresa cita del Auto del Tribunal Supremo, Sección 1ª, de 24 de octubre de 1979.

[19] VÉLEZ FRAGA, M., y GÓMEZ-IGLESIAS ROSÓN, L., “*La anulación de laudos arbitrales por vulneración del orden público en las recientes resoluciones del Tribunal Superior de Justicia de Madrid*”, Publicado en *Foro Actualidad*, 30 de mayo de 2016, pp. 87.

[20] FERNÁNDEZ ROZAS, J.C., “*Dogmática del recurso de anulación ante el CIADI*”, *Anuario Latinoamericano de Arbitraje*, nº 1, Sistema de anulación de Laudos CIADI, 2011, pp. 352-353.

[21] Madrid Appeal Court judgment 7875/2000, of 26 May, Legal Ground 3º.

[22] Real Decreto Legislativo 4/2015, de 23 de octubre, por el que se aprueba el texto refundido de la Ley del Mercado de Valores.

[23] Markets in Financial Instruments Directive.

[24] Tribunal Supremo, translated in this article to Supreme Court.

[25] Spanish Supreme Court judgement 709/2002, of 5 February, Legal Ground 2º.

[26] Madrid High Court judgment 13/2015, of 28 January followed by Madrid High Court judgment of 6 April, 14 April, 23 October and 17 November of 2015.

[27] ZARAGOZA TORIBIO, S., “*El orden público económico en el arbitraje desde la perspectiva jurisprudencial*”, *Arbitraje*, vol. XI, nº 2, 2018, pp. 570.

[28] Individual vote of the judge Vieira Morante to Madrid High Court judgment of 6 April, 14 April, 23 October and 17 November of 2015.

[29] ZARAGOZA TORIBIO, S., “*El orden público económico en el arbitraje desde la perspectiva jurisprudencial*”, *Arbitraje*, vol. XI, nº 2, 2018, pp. 567.

[30] Madrid High Court judgment 13/2015, of 28 January followed by Madrid High Court judgment of 6 April, 14 April, 23 October and 17 November of 2015.

[31] Article 24 of the Spanish Arbitration Act.

[32] *Recurso de Apelación*.

[33] Madrid High Court judgment 4/2020, of 8 January, Legal Ground 2º. b).

[34] Spanish Constitutional Court judgment 15/1989 reaffirmed on others judgment in which the most recent one is the Spanish Constitutional Court judgment of 11 January 2018.

[35] Article 37 of the Spanish Arbitration Act.

[36] CANALS VAQUER, R., “*La falta de motivación del laudo como motivo de su impugnación por infracción del orden público*”, Arbitraje, vol. XI, nº 2, 2018, pp. 550.

[37] Barcelona Appeal Court judgment 314/2010, of 13 October, Legal Ground 4º.

[38] Madrid High Court judgment 4/2020, of 8 January, Legal Ground 2º. b).

[39] Madrid High Court judgment 4/2020, of 8 January, Legal Ground 2º. a).

[40] Madrid High Court judgment 4/2020, of 8 January, Legal Ground 2º. a).

[41] *Recurso de amparo*.

[42] Spanish Constitutional Court Judgment 46/2020, of 15 June.

[43] Madrid High Court judgment 62/2015, of 17 September, Legal Ground 1º.

[44] Spanish Constitutional Court judgment 46/2020, of 15 June, Legal Ground 3º.

[45] Spanish Constitutional Court judgment 46/2020, of 15 June, Legal Ground 4º.