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Clifford J. Hendel

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Perspectives on Three Recent Annulment Decisions from Spain: Is Where You Stand Determined by Where You Sit?

by CLIFFORD J. HENDEL*

ABSTRACT

The effect of certain recent Spanish court decisions annulling arbitral awards in high-profile cases will be a subject of intense debate in Spanish legal circles. How the cases are viewed and understood by the Spanish arbitral community could have a significant effect on the development of arbitration in the country, jump-started by a 2003 UNCITRAL-based arbitration law and a series of amendments promulgated in mid-2011. Two very contrasting views are emerging: Some will see the cases as favouring the development of arbitration in Spain by setting down useful guidance as to arbitrator and counsel conduct; others will see view them as constituting unwarranted judicial meddling and thus as damaging to the development of arbitration in the country. This article frames the issues and sets out the two diverging views on the topic.

In the summer of 2009, and again (twice) in the summer of 2011, different sections (panels) of Madrid's regional high court, the Audiencia Provincial, rendered important decisions annulling arbitral awards. The 2009 decision, involving an underlying dispute of modest proportions and without particular economic or media interest in itself, generated a good deal of discussion and literature – some positive, some negative – in Spanish legal circles. The 2011 annulments, on the other hand, both involve underlying disputes of substantial economic and media interest and have already received mention in the general and business press; they will surely spawn significant discussion and literature in legal and professional circles.

If past is precedent, the critiques will again be dichotomous, revealing an apparent fault-line in the Spanish arbitral community: A certain spectrum of the

* Clifford J. Hendel is a partner of Araoz & Rueda Abogados, a Madrid firm with a broad-based business practice. His practice focuses on international transactions and international arbitration, both as counsel and as arbitrator. Qualified as an attorney in New York, an abogado in Madrid, an avocat in Paris and a solicitor in England and Wales, he has practiced in New York, Paris and (since 1997) in Madrid, hendel@araozrueda.com.

community will likely heap praise on the decisions as providing useful and appropriate lessons to arbitrators which will tend to stimulate greater confidence in the still somewhat unsteady institution of Spanish arbitration. An equally broad spectrum will likely heap scorn on the decisions as constituting unnecessary and counterproductive meddling by the courts, draining predictability from the system, encouraging litigation and generally undercutting confidence in arbitration in Spain.

Rather than taking sides on the issues, this article will try to limit itself to recounting in summary fashion the facts underlying each case, the reasoning applied in the decisions and (especially) the actual or expected perspectives of the two camps concerning the decisions.

Underlying and unifying the discussion will be the strong impression that the split in views is no more and no less than a reflection of the co-existence of two schools of thought in the Spanish arbitral community. On the one hand, a somewhat traditional school in which judicial upsetting of the arbitral *appellate* is viewed with particular hostility. And on the other, a more liberal school in which occasional judicial re-alignment of the arbitral *appellate* via annulment is actually welcomed and even embraced, if and so long as the annulments can be viewed as cautionary tales with the intent and/or effect of raising the bar of arbitrator and counsel conduct in order to foster greater user confidence in the institution.

CASE 1. JURISDICTION OF THE ARBITRATOR IN LIGHT OF AN IMPERFECTLY-DRAFTED ARBITRATION CLAUSE: THE LIMITS OF *'COMPETENCE/COMPETENCE'*?

The 2009 case involved, in essence, nothing more than the interpretation of a narrowly-drafted arbitration clause. Expressly referring only to disputes '*with respect to the interpretation*' of the agreement in question, the clause did not include broader (perhaps somewhat boilerplate) mention of substantive matters such as '*execution*', '*performance*' or '*breach*' of the agreement, or customary and similarly broad catch-all language along the lines of '*arising out of, relating to, or in connection with the agreement ...*' or similar formulations.

After an arbitration was filed seeking a declaration of breach and the assessment of damages, the respondent raised a jurisdictional objection on the basis of the terms of the arbitration clause. The arbitral tribunal rejected the objection, and issued an interim award confirming its competence to hear the matter. The Audiencia Provincial, in a short and crisply-drafted ruling, annulled the award on the grounds that questions of breach and assessment of damages consequent upon a breach were not questions of '*interpretation*' within the scope of the arbitration clause and thus not within the jurisdiction of the arbitral tribunal.

The Court reached its decision relying on a tenet of contractual construction enshrined in Spain's Civil Code pursuant to which clear contractual terms leaving no doubt as to the parties' intent will generally be given literal effect. The Court

reasoned that the express submission to arbitration only of matters involving '*interpretation*' left little or no doubt for purposes of this canon of construction as to the parties' intent *not* to submit to arbitration any and all disputes arising from the contract, but rather, only those involving its '*interpretation*'. Moreover, the court reasoned, it was or could be logical and sensible in the circumstances of the case for the parties to have agreed to submit to arbitration only '*interpretative*' matters, and not the broader range of possible disputes involving matters of performance, breach and the like. In other words, a literal reading of the clause would not necessarily give rise to a manifestly absurd result which could not have been intended; accordingly, the tribunal should have applied the clause consistently with its literal meaning, and found that the dispute as to breach was not within its competence.

In short order, a polarization of the views of the Spanish arbitral community on the merits and consequences of this decision became manifest.

To some, the decision was right and proper, a gentle reminder to counsel to be careful in drafting arbitration clauses and to arbitrators in construing them so as to avoid granting themselves jurisdiction beyond the literal scope of the matters submitted clearly and unambiguously to arbitration. From this perspective, the decision should stimulate rather than hinder the growing but still somewhat immature Spanish arbitration culture, and can be considered 'pro-arbitration'. This camp takes heart in the following observation of the Court:

Precisely because arbitration is predicated on the free will and autonomy of the parties, its furtherance and solidity comes not as much from the all-out defence of the institution (such doubtless will always be welcome) as, principally, from scrupulous respect of the agreement of the contracting parties.

To others, the decision was an over-punctilious application of the Civil Code's rules of interpretation and a departure from a general readiness in Spanish judicial practice to explore, or even presume to know, the parties' 'real' or subjective intent irrespective of seemingly clear contractual language reflecting the objective intent (real or not, far-fetched or not) manifested by that language. As such, the decision has been criticized as restrictive of the arbitrator's inherent power and responsibility to determine his or her own jurisdiction (the principle of *competence/competence*), as an invitation to further judicial challenges on this issue and as a step backwards for the development of arbitration in Spain.

CASE 2. MAJORITY DECISIONS AND THE IMPORTANCE OF COLLEGIALLY OF THE TRIBUNAL: WHERE ARE THE LIMITS?

In June 2011, Madrid's Audiencia Provincial annulled an arbitral award in a case which – due to its economic importance and the media visibility of one of the parties – received a certain amount of attention in the Spanish business press. No doubt it will soon receive similar attention in the legal press.

The case involved the question of whether, in the very last steps of an *ad hoc* arbitration before a majority award was issued, the third arbitrator had been excluded from the decision-making process and if so, whether such exclusion constituted a violation of public policy protected by the Spanish Constitution.

Summarizing, the facts of record showed that the panel had maintained a long series of deliberations aimed at reaching a unanimous decision. A final deliberation meeting among the panel came close to a unanimous decision, but terminated acrimoniously with a sharply-divided panel, and with two divergent draft awards on the table, and the possibility of the Chair's drafting a third.

Very shortly thereafter, the Chair and one of the co-arbitrators met and agreed the text of a majority award. The other co-arbitrator, whose absence from Madrid for a few days was known to his colleagues, was not informed of or invited to this meeting. After the meeting, the Chair sent the third arbitrator the text of the majority award by email, inviting him to adhere to it or dissent from it, as he preferred, but informing him that it was to be notified immediately to the parties and thus (implicitly) that he could not contribute in any respect to its content. Minutes later, the secretary of the tribunal circulated the same text by the same means to counsel, describing it as the definitive award. Shortly thereafter the award signed by the majority was issued to the parties, with a note stating that the award was issued by majority and that the third arbitrator had not 'yet' expressed his conformity with it.

In a terse and emphatic decision, the Audiencia Provincial annulled the award. Inasmuch as the final meeting attended by the entire panel had ended without result – i.e., with widely-divergent postures and without the majority having formed, crafted and presented to the third arbitrator the agreement that they ultimately reached for his review – and inasmuch as the text that was ultimately adopted by the majority was 'appreciably different' from the text reviewed at such meeting, the Court held that the non-inclusion of the third member at the meeting at which the majority award was generated and signed effectively denied him the opportunity to consider and comment on the majority text before it was issued and thus for all practical purposes excluded him from the decision-making process. On this basis, the Court annulled the award due to infringement of the 'principle of collegiality' of the arbitral panel and thus of public policy.

Divergent views of the merits of this decision have begun to be voiced in the local arbitral community.

Certain observers will find the decision a laudable exercise of judicial oversight to rein in precipitous arbitrator conduct which might, or might be perceived to, run roughshod over the form or substance of what is, after all, a contractual means of dispute resolution. And thus, again, a decision annulling an arbitral award is viewed (from this perspective) as being pro, and not anti, arbitration in general.

Another school of thought will be less indulgent towards the ruling, and will criticize it as both excessively formalistic and insufficiently legally-based.

Formally, members of this second camp might agree that there may have been an element of precipitation in the issuance of the majority award. They might concede that it could have been better practice to have invited the third arbitrator

to the meeting at which the majority was formed and agreed the result and definitive text of the award, or at least to have allowed him time to review and meaningfully participate in the final text. But they will argue that the real consequence of not observing these niceties is far from clear. Indeed, it seems likely from the facts as set out in the decision that the 'die was cast' as to the final award, in which case they will ask: Was there really any effective exclusion, and even if there was, did it make any practical difference?

Similarly, this school of thought will be critical of the limitedly-developed Constitutional basis set out in the ruling, which concludes (without particular argument or discussion) that the exclusion constituted a kind of *per se* violation of a vague and undeveloped principle of collegiality which is tantamount to a violation of the constitutionally-established principles of public policy. Where, they may ask, is this principle of collegiality established? How and where is it enshrined in the Constitution or in the umbrella concept of public policy? And, where the losing party had fully and fairly presented its case and the panel had deliberated extensively before things broke down and, inevitably, a majority was formed, what precise Constitutional right of that party was really violated, given that traditionally the concept of public policy or procedural due process in this area focuses on a party's having or having been denied the right to present its case fully and fairly?

For these reasons, and from this angle, the decision will surely be criticized for opening a Pandora's box of potential and amorphous public policy (due process) challenges, tending to further clog the courts with what in general tend to be baseless and desperate actions to avoid or postpone enforcement of adverse awards and thus causing harm to the institution of arbitration in Spain.

Again, the ruling can be viewed from two very different optics and can thus give rise to two very different readings and reactions.

CASE 3. INDEPENDENCE AND IMPARTIALITY: CAESAR'S WIFE?

Later in the same month of June, 2011, in a lengthy and somewhat rambling ruling, another panel of Madrid's Audiencia Provincial annulled a particularly high-visibility award, arising from a high-value dispute involving a leading Spanish financial institution, with a tribunal chaired by a particularly well-known Spanish legal academic, author, lawyer and arbitrator.

The Court held that a cumulus of circumstances involving relationships between the Chair and both the financial institution and its counsel was, in the aggregate, sufficient to have created such doubt as to his impartiality and independence as to have warranted his recusal, notwithstanding that viewed individually, the relationships in question would have been largely or wholly innocuous. The relationships at issue included the following:

- the fact that a principal partner (at the time of the proceedings, Managing Partner) of the large law firm representing the financial institution had worked with the Chair as a law clerk or junior lawyer for two or three years some thirty years ago, and the two remained friendly to this day;
- the fact that the Chair acknowledged having friends in the law firm in question, and that his son-in-law worked there as a result of such relationships;
- the fact that the Chair had served as a non-remunerated member of an academic advisory board to a masters program offered by a centre affiliated with the law firm and bearing its name, such service involving attending one or two meetings per year with the full board, including the Managing Partner referred to above;
- the fact that he had dedicated an academic work to the name partner of the law firm;
- the fact that over the years he had issued legal opinions for the financial institution or its affiliates, on the request of their counsel; and
- the fact that the Chair had conversed on two occasions prior to the arbitration with senior legal executives of the financial institution.

Certain other academic and academic/social relations were considered irrelevant by the Court and are not mentioned here.

The Court ruled that the circumstances listed above, taken together evidenced a relation of sufficient depth and proximity with the law firm and with the financial institution as to cast reasonable doubt on the Chair's impartiality and independence. The Court expressed the view that arbitrations in equity (as in the case under discussion) require even greater confidence and assurance of impartiality and independence than arbitrations at law, due to the freer hand that the arbitrator has in deciding at equity than when deciding at law). The Court noted that the Chair's failure to make voluntarily disclosure of certain of the relationships provided additional basis for the recusal. The Court further noted that, while the IBA Guidelines on Conflicts of Interest in International Arbitration are not applicable even as a matter of orientation, the relations involving the son-in-law and the legal opinions were such as to constitute waivable, 'orange list' items under the IBA Guidelines, so that if they were applicable the Chair's non-disclosure would be questionable. (The Court did not make reference to the Spanish equivalent of the IBA Guidelines, the Recommendations on the Independence and Impartiality of Arbitrators issued by the Spanish Arbitration Club, which express, like the IBA Guidelines, the general fallback or 'golden rule' in the area, i.e., the maxim 'when in doubt, disclose').

By now, the pattern is clear: the ruling – having created great waves in the sector due to the visibility of the dispute, the disputants, the arbitrators and counsel – has already been the subject of heated and polarized reaction.

Proponents applaud the message that a series of relatively innocuous relationships, even and perhaps especially among leaders of the tightly-knit Spanish legal community, can be sufficient to require recusal, especially if not

disclosed promptly and voluntarily. Viewing Case 1 as constituting a deserved and commendable slap on the wrists of both counsel whose drafting is imprecise and arbitrators who have difficulty in resisting the temptation to expand the scope of their competence beyond the parties' manifested intent, and Case 2 as constituting a deserved and commendable reminder that arbitral forms are no less important than arbitral substance and formal dereliction is precisely what the courts are charged with monitoring, Case 3 (for the proponents) is an appropriate and high-visibility cautionary tale, an orange traffic light warning the clubbish Spanish arbitral community to be ever-mindful of the importance not only of being impartial and independent, but also of appearing to be impartial and independent. Thus, the ruling is seen by many as pro-arbitration, inasmuch as they believe it will increase user comfort with the impartiality and independence of arbitrators, strengthening confidence and trust in the institution and furthering its growth.

Again, there is another side of the coin. Opponents of the decision will be particularly vociferous due to the interest, individuals and institutions involved and the ramifications of the case: after all, not every case involves imperfect arbitration clauses (Case 1) or colourable arbitral misconduct (Case 2), but every case involves arbitrators selected precisely because they are known to counsel and/or the parties and thus every case involves the issue of potentially disclosable relationships.

Among the questions that the opponents will raise are: Where exactly was the tipping point in the case, i.e., when did a series of innocuous relations (viewed individually) become meaningful when viewed together? And if the tipping point is not clear, will the ruling simply result in confusion and litigation rather than providing guidance to avoid the same? Is there really any merit in the Court's statement that the impartiality and independence concerns in cases decided in equity are greater than those decided at law? And if this is the case, what is the relevance of the decision in the typical international proceeding, decided at law? Will this prove to be yet another source of confusion and litigation rather than guidance? Why does the Court refer to the IBA Guidelines but indicate so emphatically that they are not applicable even as guidelines? Is it because the dispute was domestic? Why does the Court fail to mention the Recommendations of the Spanish Arbitration Club? Does this too generate confusion and uncertainty when using them as they were intended, as guidelines as to best practices, might do the opposite? And finally, where does the 'slippery slope' of disclosure take us in a rather small and concentrated business environment and a smaller and more concentrated legal market, in which a relatively limited number of academics and law firms tend to be involved in most of the significant transactions and the disputes that arise from them? How can the maintenance of 'normal', friendly relations between and among arbitrators and counsel be so suspect in a small community that the failure to disclose them can be considered recusable?

It will be interesting to see how the views of the Spanish legal and arbitral community on the two 2011 cases will actually develop, and whether the dichotomy of views suggested in this piece is really confirmed. The author's expectation is that anyone who likes the result and lesson of Case 1 will also like those of Cases 2 and 3, and inversely, anyone who does not like Case 1 will not like

Cases 2 or 3. And that each camp will lift its voices and its pens in support of its position.

Both camps will find arguments, both legal and of a policy nature, to support their views. Both will argue, not without some force, that their views are pro-arbitration.

The trio of decisions would seem a classic case of the hoary maxim that 'where you stand is where you sit'; their real impact on arbitration in Spain will likely only be known some years down the road.