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In a judgment of the High Court of Justice of Madrid of October 11, 2016 (Judgment No. 62/2016), the court partially set aside a final award with respect to its decision on costs. In reaching this decision, the court examined the arbitrator's reasons to allocate all arbitration costs to one of the parties notwithstanding the fact that only some claims had been upheld, and concluded that the arbitrator's decision on costs violated Spanish public policy.

The High Court's judgment dealt with the arbitrator's interpretation of Spanish case law, which in our view exceeded the powers of the court under the Spanish Arbitration Act.

Background

In December 2005, A, the "**Claimant**" and B, the "**Respondent**" (both shareholders of company C, also a Respondent) entered into a swap or transfer agreement by which A would acquire all the shares of company D, and B would acquire all the shares of company E (the "**2005 Agreement**").

Subsequently, in its general shareholders' meetings of December 29, 2014, and February 6, 2015 company C adopted two resolutions to reduce its equity. These resolutions had a negative impact on the rights of A as the minority shareholder in reference to the 2005 Agreement.

Under these circumstances, A initiated arbitration against B and C, claiming (i) EUR 1,000,000 under the penalty clause in the 2005 Agreement; (ii) EUR 299,999 in damages (29.999% of the penalty clause proportional to A's share in C; and (iii) reimbursement of a certain amount. A sole arbitrator, Mrs. Carmen Núñez-Lagos, rendered the award under the Arbitration Rules of the Court of Arbitration of the Madrid Official Chamber of Commerce and Industry.



The sole arbitrator partially upheld the claim by (i) ordering B and C to fulfill the 2005 Agreement; (ii) ordering B and C to adopt the necessary measures to revoke the resolutions of December 29, 2014 and February 6, 2015; (iii) ordering B to pay damages of EUR 20,000; (iv) ordering C to not sell a certain property until the 2005 Agreement had been fulfilled; and (v) ordering B to pay the entire costs of arbitration. As the claim for breach of the 2005 Agreement had been successful, the sole arbitrator decided that the Supreme Court doctrine of “substantial win” (*vencimiento sustancial*) was applicable and that therefore B had to bear all arbitration costs. Further, the arbitrator rendered a clarification award, correcting certain calculations and dismissing all other requests.

The Respondents filed an action to set aside the award with respect to costs for being inconsistent with the decision on damages and contrary to public policy. One of the issues before the High Court was whether the arbitrator had sufficient grounds to impose the entire arbitration costs on B, since Claimant’s claims had only been partially upheld.

Decision

The court examined the Respondents’ allegations and dismissed those related to an excess of powers (*ultra petita*). However, the court went on to examine the second ground for setting aside the award and held that the arbitrator had violated Spanish public policy in its decision with respect to the allocation of costs.

The court stated that the arbitrator had erroneously applied the “substantial win” doctrine of the Supreme Court in the award because in the eyes of the High Court the main claim was not the one for breach of contract – as the arbitrator reasoned in the award – but the claim for EUR 1,000,000 resulting from application of the penalty clause, which the arbitrator had dismissed.

Moreover, the High Court based its decision on the fact that the award itself recognized that A had never required the performance of the 2005 Agreement before commencing arbitration, that B had not materially breached the 2005 Agreement, and that the obligations established in the 2005 Agreement had not been fulfilled for reasons attributable to the Claimant.

Thus, the High Court disagreed with the arbitrator’s interpretation of the Supreme Court doctrine, finding that the arbitrator had wrongly interpreted Spanish law and that the arbitrator’s decision with respect to costs was contrary to mandatory rules, which in turn violated Spanish public policy. The High Court therefore declared that allocating the entire arbitration costs to B was contrary to Spanish public policy and set aside the award with respect to costs.



Comment

In our opinion, the High Court's review goes well beyond the limits that the Spanish Arbitration Act sets for ordinary courts in reviewing awards. On one hand, it should be recalled that under Article 37.6 of the Spanish Arbitration Act parties are free to decide how to apportion and allocate the arbitration costs (*"subject to the parties' agreement, the award will include the arbitrators' decision on the arbitration costs (...)"*). Therefore, this is not, and cannot be, a mandatory rule. If this is a subject matter left to the free disposal of the parties, it is hard to see how the arbitrator's decision could be contrary to public policy. The Spanish Supreme court has repeatedly stated that public policy could be defined as the *"basic legal rules or standards not subject to the will of the parties."*

Moreover, it is settled under Spanish law that the ordinary courts cannot revise an arbitrator's application of the law. Whether the arbitrator's decision is right or wrong in the interpretation of the law, the action to set aside is not an appeal and the High Court cannot review the merits of the award. Yet, this is precisely what the High Court did, both with respect to the facts and the law in this case.

Therefore, we think that the High Court of Madrid clearly overstepped its bounds and should have dismissed the request to set aside the award on grounds of public policy.