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Client Alert

MARCH 3, 2021

The Spanish Constitutional Court Bolsters Arbitration in Spain

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In a landmark ruling handed down on 15 February 2021, the Spanish Constitutional Court confirmed that the standard for the review of arbitral awards on public policy grounds should be extremely narrow and the right to a reasoned award must be interpreted strictly. This ruling continues the Constitutional Court's long-standing favorable view of international arbitration and comes on the heels of another important decision of 15 June 2020, where the Constitutional Court limited the notion of public policy and endorsed the principle of party autonomy as inherent to arbitration. Both rulings have been key in deciding the fate of arbitration in Spain and confirming that it is a safe jurisdiction for international arbitration.

BACKGROUND

Pursuant to the Spanish Arbitration Act, an arbitral award may be challenged on six narrow grounds before the Spanish High Courts of Justice (*Tribunales Superiores de Justicia*). Of the six grounds for annulment, public policy is the most commonly raised by litigants as well as the most successful. A report from 2018 (Fieldfisher JAUSAS) shows that the Madrid High Court granted 21% of all annulment actions (38 applications), and five of eight applications for violation of public policy.

Spanish courts have struggled to define and circumscribe the nebulous notion of public policy, which remains imprecise and undetermined even today. As a result, parties have been relying extensively on public policy in their attempt to vacate arbitral awards rendered against them, which in turn has led to an expansive interpretation of public policy by certain Spanish High Courts. Public policy comprises those principles and essential rules enshrined in the Spanish Constitution that are required for the preservation of social order. Like many jurisdictions, Spain distinguishes between procedural and substantive public policy.

In 2015, the Madrid High Court expanded the public policy ground for annulment of awards by introducing the controversial notion of economic public policy. On this basis, it proceeded to review the arbitrators' reasoning and assessment of evidence and, among other things, annulled awards relating to the validity of swap agreements entered into between banks and consumers. Those rulings, which amounted to a re-examination of the merits of the case, were heavily criticized by the arbitral community who feared that the Madrid High Court's broad interpretation of the concept of public policy would transform a set-aside application into a full-blown second instance proceeding.

Against this backdrop, recent decisions issued by the Constitutional Court on 15 June 2020 and 15 February 2021 are pivotal in curbing the Madrid High Court's expansive interpretation of public policy. These two rulings are presented below:

CONSTITUTIONAL COURT RULING OF 15 JUNE 2020: TOWARDS A NARROWER CONCEPT OF PUBLIC POLICY AND ENDORSEMENT OF THE PRINCIPLE OF PARTY AUTONOMY

After arbitration proceedings initiated by a landlord against a tenant for alleged non-payment of rent a sole arbitrator issued an award in favor of the landlord. Displeased, the tenant challenged the award on the ground that the arbitration clause was null and void because it was abusive in nature (Article 41.1.a) of the Spanish Arbitration Act). The Madrid High Court added *sua sponte* a public policy challenge (for a potential lack of impartiality of the administrating arbitration court) and asked the parties to argue it. Meanwhile, the parties reached a settlement agreement and jointly requested that the case be dismissed. But the Court refused and held a hearing that neither party attended. Despite the parties' settlement, the Madrid High Court issued a judgment annulling the arbitral award on the ground that it was contrary to public policy. It first concluded that the annulment action could not be withdrawn because the Court had a duty to safeguard the general interest *ex officio*. And, on the merits, the Court ruled that the award manifestly lacked objective impartiality because the administering arbitral institution (the European Association of Arbitration; AEADE) had direct ties with the property manager (Arrenta) who represented the landlord in the negotiation of the parties' rental agreement at issue.

The Constitutional Court reversed the decision on appeal by both parties. It ruled that the Madrid High Court's decision was contrary to the constitutional canon of reasonableness of judicial decisions because the parties have a constitutional right to terminate proceedings before a decision is handed down by a judicial authority. With respect to public policy, the Constitutional Court concluded that "[p]recisely because the concept of public policy is not that clear, the risk that it be converted into a mere pretext for a judicial body to reexamine the questions debated in the arbitral proceeding is multiplied, thereby stripping the arbitral panel of its task and in the end infringing the will of the parties." The arbitration community welcomed this decision.

CONSTITUTIONAL COURT RULING OF 15 FEBRUARY 2021: TOWARDS A HIGHER STANDARD FOR REVIEW OF ARBITRAL AWARDS CHALLENGED ON PUBLIC POLICY GROUNDS

This recent Court decision stems from a dispute relating to the €600 million estate of Marquis de Paul, a member of Málaga's prominent Larios Family. A dispute opposed widow Bárbara Kalachnikoff and their two daughters to Carlos Gutierrez-Maturana-Larios Altuna, a son of a previous marriage, and it related to Altuna's opposition to the dissolution and the distribution of the assets of holding company Mazacruz, which owned the properties and possessions of the late Marquis de Paul.

A sole arbitrator ruling on equity found that Altuna had abused his dominant position in opposing the dissolution and ordered that the company be liquidated, and the proceeds distributed in accordance with each partner's shareholding, regardless of voting rights. Altuna challenged the arbitral award before the Madrid High Court. After stating that the arbitrator in equity was entitled to order the dissolution the Court nonetheless annulled it for violating of public policy, finding that the arbitrator's reasoning and assessment of evidence had been insufficient.

The Kalachnikoffs brought the matter to the Constitutional Court, which found that the High Court's decision violated the right to effective judicial protection by reopening the merits of the dispute: "the possible judicial control of the award and its acceptance of public policy cannot lead to the consequence that the judicial body replaces the arbitral tribunal in its duty to apply the law". The Constitutional Court clarified that, when ruling on public policy challenges, courts may not carry out a review of the merits of the case and that the duty to issue a reasoned award is only breached when the award is "arbitrary, illogical, absurd or irrational". In other words, the arbitrator's assessment of the evidence should only be ruled upon when it is arbitrary, illogical, absurd or irrational.

IMPACT OF THE CONSTITUTIONAL COURT'S RULINGS

Spain historically has been an arbitration-friendly jurisdiction with a favorable legal framework and a judicial system supportive of arbitration. The Constitutional Court's recent rulings confirm this and put an end to an expansive interpretation of public policy by the Madrid High Court and confirmed that set-aside proceedings in Spain are not to be assimilated with a second instance on the merits. Spain remains a reliable and relevant venue for national and international arbitrations.