Kluwer Arbitration Blog

Madrid High Court of Justice and the Setting Aside of Arbitral Awards

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Part I

In a judgment dated 5 April 2018 (Case nº 6/2017), the Madrid High Court of Justice ("TSJM"), the competent court to hear applications to set aside an award when the seat of the arbitration is Madrid, set aside an arbitration award on public policy grounds after finding that the tribunal "[…] unjustifiably omitted to assess evidence that was relevant for the resolution of the case".

In recent years, Spain has experienced an impressive increase of arbitration cases. The TSJM has handled an unusual number of applications to set aside arbitration awards based on a wide array of grounds and has granted a significant part of these applications. Many in the Spanish and international arbitration community have raised concerns that the TSJM is too easily prone to review the merits of awards. Statistics show a rather high rate of successful applications for setting aside (26.6 %) (here). The matter, however, seems too nuanced and complex to sum up, and definitive conclusions cannot be hastily made on the sole basis of statistics.

This post is divided into two parts. The first part will discuss the facts of the above case, the arbitration proceedings and the TSJM's judgment dated 5 April 2018. Thereafter, the second part will illustrate some thoughts and views about the particular stage of development of arbitration in Spain and the TSJM's trend to review the merits of awards.

The facts of the case and the arbitration

The case involved a turnkey contract for a wind farm project between owner, Engasa Eólica ("Engasa"), and contractor, Vestas Eólica ("Vestas"). The core issue in dispute was whether or not the parties agreed upon a valid and enforceable limitation of liability provision with respect to the civil construction works required for the project.

Some years after the wind farm had become operational, Engasa claimed that Vestas was responsible for certain defective construction works under the turnkey contract. Engasa took the matter to arbitration and sought that Vestas be ordered to repair the defective construction works (specific performance) or, alternatively, to pay damages. Vestas denied the claim by invoking the limitation of liability provision. Vestas maintained that the parties concluded a valid limitation of liability provision by way of an exchange of emails between them during the negotiations leading

to the signature of the turnkey contract. Engasa disagreed and argued that it never consented to any such limitation of liability.

The tribunal concurred with Vestas. In taking the decision, the tribunal relied on the contents of that set of emails as well as corroborating witness testimony. It was satisfied that the parties only signed the turnkey contract to meet a requirement of the financing banks. The tribunal assumed that the banks were not prepared to finance the project unless Vestas (given its good track record in the energy renewable sector) accepted to act as contractor under a standard turnkey contract ?also referred to as an Engineering, Procurement and Construction (EPC) contract.

Regardless of the turnkey contract the parties had signed, the tribunal found that their mutual intention was, in fact, that Engasa would select and pay another engineering company, Isolux, for the whole of the project's civil construction works whilst Vestas would supply, start up, and maintain the turbines and related equipment. In other words, from a common law contract terminology perspective, it could be said that the tribunal found that the consideration stated in the turnkey contract did not reflect the true intention of the parties and therefore did not bind them.

The tribunal was satisfied that Engasa, in that set of emails, agreed to waive any claim against Vestas that would be outside the said scope of supplies, start up and maintenance undertakings. It would have made little commercial sense for Vestas to accept to remain liable for Isolux's potential non-performance or negligence under the circumstances. The tribunal also considered that Engasa decided to pay Isolux directly for the advance of the construction works.

The tribunal concluded that Vestas and Engasa had agreed upon a valid and enforceable limitation of liability provision that excluded Vestas' liability for the defective construction works carried out by Isolux.

Dissenting arbitrator

The tribunal was composed of three arbitrators, and one of them issued a dissenting opinion holding that Vestas and Engasa entered into nothing but a true standard turnkey contract, and therefore Vestas, as contractor, was globally liable for all the construction works and supplies related to the project. According to the dissenting arbitrator, Vestas could have claimed recovery from subcontractors for the faulty performance of the latter, including, of course, from Isolux.

The dissenting arbitrator relied on an additional set of emails submitted to the tribunal that the majority did not consider at all. It appears, however, that the dissenting arbitrator did not give any weight to the circumstance that Engasa selected and paid Isolux directly for the whole of the project's civil construction works, a circumstance which would be incompatible with the predicate that Vestas and Engasa had entered into a standard turnkey contract.

Engasa approached the TSJM to set aside the award

Engasa moved to the TSMJ seeking that the award be set aside on public policy grounds under Article 41 (1) (f) of the Spanish Arbitration Law (SAL). The grounds for setting aside in the SAL are exhaustive, reflecting the UNCITRAL Model Law standards. Engasa put forward, inter alia,

the argument that the majority voting "[…] irrationally assessed the evidence and the applicable law […]". It contended that the flawed assessment of the evidence by the tribunal led to an "irrational outcome in the award".

The TSJM used the public policy argument as a door to open a review of the merits of the award and finally set it aside. The TSJM effectively undertook a de novo review of the issues in dispute and held that the arbitral tribunal "unjustifiably omitted to assess evidence that was relevant for the resolution of the case".

The TSJM underscored that the dissenting arbitrator relied upon another set of emails and documents submitted to the tribunal that the majority vote did not consider at all in the award and held "[…] those means of evidence […] relied upon by the dissident opinion required a proper analysis, even if it were to explain why they did not undermine the arguments put forward by the two arbitrators of the majority. The absolute silence about those means of evidence, without any explanation or justification, causes an appearance of arbitrariness in the arbitral tribunal […]". The TSJM cited one of its own precedents in support of its conclusions: "[…] under certain circumstances, the assessment of the evidence ?as put forward in the reasonings? may infringe due process and therefore infringe public policy" [ROJ:STSJ M 11066/2017-ECLI:ES:TSJM:2017:11066].

Assessment

The TSJM's reasoning and conclusions are unfortunate and depart from mainstream arbitration rules and practice.

Article 25 SAL (based on Article 19 Model Law) provides that evidential questions of admissibility, relevance and materiality are clearly within the sole sphere of the arbitral tribunal. The assessment of evidence is a matter for the tribunal, not for the court.

The arbitral tribunal's duty is to decide the issues put before it, and to provide reasons in the award. This duty does not require the tribunal to refer to all the evidence submitted. The TSJM cannot determine ?as it did in this case? what evidence is relevant for the case, unduly interfering with the tribunal's decision on the merits.

It appears that the members of the arbitral tribunal simply disagreed on the merits of the dispute and the set of documents they relied upon to support their respective findings. The dissenting opinion, as one may observe from the TSJM's ruling, does not at all suggest any appearance of arbitrariness or procedural unfairness or unequal treatment to the parties throughout the proceedings, let alone any impropriety during the tribunal's deliberations leading to the final award. The dissenting opinion, therefore, cannot form the basis for challenging the award.

One cannot appreciate any infringement to public policy as provided for in Article 41 (1) (f) SAL as to justify the TSJM's decision for vacating the award. The TSJM's decision is final and subject to no appeal or recourse in accordance with Article 42 (2) SAL.

By accepting arbitration, the parties undertake to carry out the award without delay and waive the right to an appeal on the merits, meaning the award was only subject to a very narrow scope of judicial review. If anything, the TSJM's ruling is likely to encourage attempts to mount appeals on

the merits disguised under Article 41 (1) (f) challenges.

Having discussed the TSJM's reasonings in setting aside the award made in the Engasa vs. Vestas arbitration, Part II, as noted earlier, will raise some thoughts and views on the particular stage of development of arbitration in Spain and the TSJM's trend to review the merits of awards.

Part II

In Part I, the TSJM's reasoning in setting aside the award made in the Engasa vs. Vestas arbitration was discussed in detail.Now the discussions will focus on the particular stage of development of arbitration in Spain and the TSJM's trend to review the merits of awards.

An unprecedented growth of arbitration in Spain

The SAL, modelled on the UNICTRAL Model Law, was passed in 2003 and amended in 2011. The new law triggered an unprecedented growth in the number of arbitrations with a seat in Spain (here). Madrid and Barcelona (and likely in that order) are by far the most frequently chosen venues for arbitration in Spain. There has been a significant volume of new entrants at all levels of an emerging (and profitable) niche of the legal market (here). The new entrants naturally have different levels of arbitration expertise. In addition, only in 2011 was the TSJM vested with the authority to hear applications to set aside awards after a major reassignment of judicial functions related to arbitration brought about by said amendment to the SAL. Previously that authority resided in the first instance civil courts of Madrid. According to the preamble of the 2011 amendment, the legislator conferred jurisdiction on the TSJM (and the respective High Court in each Autonomous Community of Spain), to hear applications to set aside, for the sake of "uniformity".

As discussed, the TSJM granted a rather high number of applications to set aside awards, but actually many of them resulted from lethally-flawed arbitration proceedings with manifest breaches of due process (here here here), lack of transparency (actual or perceived) and conflict of interests of local arbitral institutions (Case nº 120/2013 and here here), as well as dubious arbitrability of the subject matter of the dispute (here).

In other cases, the TSJM vacated pro-bank awards, resulting from disputes related to the sale of complex financial products to consumers, for infringements of Spanish and EU economic public policy (Cases nº 20/2014 and 59/2014). Although these decisions raised controversy, the TSJM ultimately followed the principle laid down by the ECJ in the well-known Ecco Swiss case. Arbitration cannot be used to circumvent mandatory rules of public policy.

The TSJM, however, sometimes confuses its role by handling applications to set aside arbitration awards as if they were appeals on the merits. In those cases, in effect, the TSJM appears to function as an appeal court reviewing a first-instance court judgment. The TSJM is a collegiate court composed of three judges, one of whom issued a dissident vote with a strong warning in this respect (Case nº 59/2014):

"[…] it is necessary to define the powers of this Chamber when entertaining an action for

annulment of an arbitral award so as not to confuse them with those of a Court of Appeal".

For example, as discussed in Part I, the TSJM vacated the arbitral award made in Engesa vs. Vestas after reviewing *de novo* the issues discussed in the arbitration and concluding that the tribunal's assessment of evidence involved an "appearance of arbitrariness in the arbitral tribunal". After a thorough analysis of the TSJM's judgment, one can only observe that the tribunal rendered a perfectly reasoned award based on documentary evidence (primarily a set of emails exchanged between the parties) which appeared to be corroborated by witness testimony. The TSJM had been unfair to hold that the tribunal acted with arbitrariness.

In another recent case, the TSJM was called upon to set aside an arbitration award made by an ICC tribunal on grounds of an alleged breach of due process (here). In this case, the tribunal refused to grant a party's request for disclosure of documents that were in the possession of the other party. The tribunal had skillfully narrowed the issues in dispute and decided that the requested documents were not material to the resolution of the case. The tribunal's decision disallowing disclosure was reasonable and predictable under ICC Rules and practice. The TSJM, however, gave no deference to it and reviewed *de novo* the issues discussed in the arbitration to finally conclude that the requested documents would not have changed the outcome of the arbitration. Although the award was not set aside, the standard of review used by the TSJM was again intrusive. There had been no violation of due process, let alone a manifest or egregious one.

In some advanced jurisdictions, for example, Hong Kong, the threshold to be met to set aside an award for want of due process is very high, requiring that "[…] the conduct of the Tribunal must be sufficiently serious to offend our most basic notions of morality and justice" (here).

One cannot definitively say that the TSJM has adopted an anti-arbitration stance although its tendency to use public policy arguments as a door to review the merits of awards may cause disruption to the development of Madrid as an emerging arbitration center.

A considerable number of Spanish multinational corporations ?in sectors such as infrastructure, construction, telecommunications, finance, oil and energy? have become world leading players and gained leverage to include ICC (and others) arbitration clauses, providing for arbitration with seat in Madrid, into their international business transactions. There has been a proliferation of arbitration clauses of this sort. Parties from Latin America, Eastern Europe and North America are known to come to Spain to arbitrate their disputes with Spanish counterparts.

Madrid has a unique opportunity to start to build its own tradition of arbitration. To this end, however, it is crucial that the TSJM's standard for reviewing awards be brought in line with international best practice. Arbitration users are understandably risk-averse and may not take too long to choose other safer seats for their arbitrations, within or outside of Spain.

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