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JUDGMENT OF THE SPANISH SUPREME COURT 102/2017
FEBRUARY 15, 2017
LIABILITY OF ARBITRATORS: THE "PUMA" DECISION

Procedural Background:

This judgment of the Spanish Supreme Court originates in an arbitration agreement in a distribution contract between the Puma AG RDS ("***Puma***") and the Spanish distributor of its products, Estudio 2000, S.A. ("**Estudio 2000**"). In an *ad hoc* arbitration between the Parties to this distribution agreement, the defendants (Mr. Temboury Redondo & Mr. Ramallo García) were the arbitrators appointed by the Spanish distributor and the president of the arbitral tribunal, respectively. The arbitrator appointed by Puma was Mr. Gastón de Iriarte.

The arbitral tribunal issued an award dated June 2, 2010 ordering Puma to pay Studio 2000 the amount of EUR 98.19 million. The award was signed by the arbitrators-defendants, but not by the arbitrator appointed by Puma.

On June 10, 2011 the Provincial Court of Madrid set aside the award (Judgment nº 200/2011) on the basis that the arbitral tribunal had deliberated, voted and issued the award without the participation of the arbitrator appointed by Puma in breach of the principle of arbitral collegiality, which constituted an infringement of the right of defence and in turn a violation of public policy (see Article 41.1(f) of the Arbitration Law, and Article 24 of the Spanish Constitution).

Estudio 2000 resubmitted its claim before a new arbitral tribunal. This second arbitration ended with an award of damages 60% lower than that one in the original arbitration.

Puma then commenced court proceedings against the arbitrators-defendants seeking the recovery of the fees paid by Puma to them (amounting to EUR 750,000 for each defendant). The action was based on Article 21.1 of the Arbitration Law, which reads (in part) as follows:

> *"**Article 21. Responsibility of the Arbitrators and of the Arbitral Institutions. Provision of Funds.** Acceptance obliges the arbitrators and, where applicable, the arbitral institution to comply faithfully with their responsibilities, being, if they do not do so, liable for the damage and losses they cause by reason of bad faith, recklessness or fraud. Where the arbitration is entrusted to an arbitral institution, the injured party shall have a direct action against the institution, regardless of any actions for compensation available against the arbitrators."*

On September 20, 2013 the Court of First Instance No. 43 of Madrid found the arbitrators-defendants liable (ordinary proceeding 1880/2012) on the basis that the award has been issued recklessly, finding that the Defendants had been guilty of a 'manifest, serious and inexcusable error' in believing that they could issue a majority award without convening further with the third arbitrator. For the court, the arbitrators-defendants had stonewalled the third arbitrator and took the opportunity to hold the deliberations, issue and notify the award when they knew that the third arbitrator was travelling. The Judge noted that collegiality is a fundamental principle of arbitration, recognized in Articles 35 and 37 of the Spanish Arbitration Law, and furthermore that deliberation is the manner of forming the will of an arbitral tribunal, which is known by those, such as the Defendants, who are lawyers by profession. The court also made an award of costs against the arbitrators-defendants. The defendants appealed.

On October 27, 2014, the Provincial Court of Appeal of Madrid affirmed the decision of the Court of First Instance (Appeal 75/2014), and imposed costs on the arbitrators-defendants. The defendants again appealed. The Supreme Court confirmed the liability of the arbitrators-defendants, also ordering them to pay the costs of the proceedings.

The Supreme Court Judgment

An unofficial translation of the Supreme Court judgment dated February 15, 2017 is enclosed. The opening section of the Judgment ('Factual Background') deals with procedural issues relating to the grounds for appeals to the Spanish Supreme Court. The next section of the judgment ("Legal Grounds") provides the reasoning for the dismissal of the appeal.

The proven facts regarding the circumstances of the issue of the award by the arbitrators-defendants are set out in points (i) to (vi) of the First Legal Ground. The legal reasoning of the Supreme Court in respect of the liability of an arbitrator pursuant to Article 21.1 of the Arbitration Law appears in the Second Legal Ground.

* * *

Puma was represented in the second arbitration, as well as in all instances before the Spanish courts, by partners Bernardo Cremades, Angel Tejada and Javier Juliani and associate Rodrigo Cortes of the law firm of *B. Cremades & Asociados*. Andrea Pinna of *De Gaulle Fleurance & Associes* in Paris acted as co-counsel.

B. Cremades & Asociados
Madrid, 1 March 2017

CASSATION AND VIOLATION OF PROCEDURE No.: 3252/2014
Judgment delivered by: His Excellency Mr. José Antonio Seijas Quintana
Clerk of the Court: The Honorable Mr. José María Llorente García

SUPREME COURT
Civil Chamber

Judgment No. 102/2017

Their Excellencies:
Mr. José Antonio Seijas Quintana
Mr. Antonio Salas Carceller
Mr. Francisco Javier Arroyo Fiestas
Mr. Eduardo Baena Ruiz

In Madrid, on 15 February 2017.

This Chamber has heard the appeals for procedural violation and cassation against the judgment issued on appeal by the Eighth Section of the Provincial Court of Madrid, as a result of ordinary proceedings No. 1880/2012, before the Court of First Instance No. 43 of Madrid. The appeals were filed before the Provincial Court by the legal representative of Mr. Miguel Temboury Redondo, the Court Agent Mr. Ramón Rodríguez Nogueira, and Mr. Luis Jacinto Ramallo García, represented before this Chamber by the Court Agent Mr. Isidro Orquín Cedenilla. The respondent, Puma S.A., is represented by the Court Agent Mr. Victorino Venturini Medina.

The judgment is delivered by His Excellency Mr. José Antonio Seijas Quintana.

FACTUAL BACKGROUND

FIRST.- 1.º.- The Court Agent, Mr. Victorino Venturini Medina, on behalf and in representation of Puma S.E, filed a claim in ordinary proceeding against Mr. Luis Jacinto Ramallo García and Mr. Miguel Temboury Redondo, alleging the facts and legal grounds that he considered applicable. The claim requested that the Court issue a judgment:

"ordering each of the defendants to pay Puma the sum of seven hundred and fifty thousand euros (750,000 Euros, with interest on that amount from the date of the claim until the effective payment day in accordance with the provisions of Articles 1108 of the Civil Code and 576 of the Law of Civil Procedure and costs".

2.º.- The Court Agent, Mr. Román Rodríguez Nogueira, on behalf and in representation of Mr. Miguel Temboury Redondo, answered the claim, alleging the facts and legal grounds that he considered applicable, concluding with a request to the Court to issue a judgment:

"dismissing the claim in its entirety and ordering the claimant to pay the costs incurred".

The Court Agent, Mr. Isidro Orquín Cedenilla, on behalf and in representation of Mr. Luis Jacinto Ramallo García, answered the claim, alleging the facts and legal grounds that he considered applicable, concluding with a request to the Court to issue a judgment:

"dismissing the claim in its entirety and ordering the claimant to pay the costs incurred".

SECOND.- After the corresponding procedural formalities and considering the evidence proposed by the parties, and admitted into the record by the court, the Judge of the Court of First Instance No. 43 of Madrid issued a judgment on 20 September 2013, the operative part of which is as follows, DECISION

«I accept the claim filed by the legal representative of the company Puma, S.E. against Mr. Luis Jacinto Ramallo García and Miguel Temboury Redondo; I order each of the defendants to pay to the claimant the sum of seven hundred and fifty thousand Euros (750,000 Euros) plus the legal interest of this sum from the date of the filing of the claim. The defendants shall pay the costs of the present proceedings.».

THIRD.- The legal representatives of Mr. Luis Jacinto Ramallo García and Mr. Miguel Temboury Redondo appealed this judgment. The Eighth Section of the Provincial Court

of Madrid issued its judgment dated 27 October 2014, the operative part of which is as follows:

«we must dismiss the appeals brought by the representatives of Mr. Luis Jacinto Ramallo García and Mr. Miguel Temboury Redondo, against Puma S.E., against the judgment issued on 20 September 2013 by the Court of First Instance No. 43 in Madrid, ordinary proceedings 1880/2012, which is fully confirmed, with the imposition of the costs of this appeal on the appellants».

FOURTH- Against this judgment, Mr. Miguel Temboury Redondo filed an extraordinary appeal for the violation of procedure, based on the following: Grounds: Sole.- Under the provisions of Article 469.1. 2º of the Law of Civil Procedure, the infringement of Article 218.1 of the Law of Civil Procedure is invoked because the judgment is incoherent.

Mr. Miguel Temboury Redondo also sought cassation on the following grounds: First.- Under the provisions of Article 477 of the Law of Civil Procedure, Mr. Temboury alleges the violation in the appealed judgment of the applicable rules to resolve the matters at issue and, in particular, Article 21.1. of the Arbitration Law for failing to apply the legal requirements for the assessment of the liability of arbitrators. Second.- Under the provisions of Article 477.1. of the Law of Civil Procedure, the judgment violates the applicable rules to resolve the matters at issue and, in particular, both Article 21.1. of the Arbitration Law and the case law that defines the concept of gross negligence in the application of the requirement of recklessness established in the above-mentioned Article 21.1.

The representative of Mr. Luis Jacinto Ramallo García filed an extraordinary appeal for the violation of procedure based on the following grounds: Sole.- On the basis of section 4 of Article 469.1 of the Law of Civil Procedure, for obvious error, arbitrariness and irrationality in the assessment of the evidence, violating the right of due process set forth in Article 24 of the Spanish Constitution.

He also filed an appeal in cassation. Sole.- Violation of Article 21.1. of the Arbitration Law.

FIFTH.- The proceedings were referred to the Civil Chamber of the Supreme Court, which by an order dated 20 July 2016 ordered as follows:

«1°) Reject the extraordinary appeal for the violation of procedure filed by the legal representative of Mr. Miguel Temboury Redondo against the Judgment issued on 27 October 2014, by the Provincial Court of Madrid (Section 8), in the appeal file No. 75/2014, arising from ordinary

proceedings No. 1880/2012 of the Court of First Instance No. 43 of Madrid, who will forgo the deposit made by reason of that appeal.»

«2º) Reject the extraordinary appeal for the violation of procedure filed by the legal representative of Mr. Luis Jacinto Ramallo García against the Judgment issued on 27 October 2014, by the Provincial Court of Madrid (Section 8), in the appeal file No. 75/2014, arising from the ordinary proceedings No. 1880/2012 of the Court of First Instance No. 43 of Madrid, who will forgo the deposit made by reason of that appeal.»

«3°) Proceed with the appeal in cassation filed by the legal representative of Mr. Miguel Temboury Redondo against the Judgment issued on 27 October 2014, by the Provincial Court of Madrid (Section 8), in the appeal file No. 75/2014, arising from ordinary proceedings No. 1880/2012 of the Court of First Instance No. 43 of Madrid.»

«4°) Proceed with the appeal in cassation by the legal representative of Mr. Luis Jacinto Ramallo García against the Judgment issued on 27 October 2014, by the Provincial Court of Madrid (Section 8), in the appeal file No. 75/2014, arising from ordinary proceedings No.1880/2012 of the Court of First Instance No. 43 of Madrid.

«5°) And to provide copies of the appeals in cassation filed by the appellants, together with their accompanying documents, in order to formalize the opposition in writing within a period of twenty days.»

SIXTH.- Once the appeals have been admitted to proceed and their service is completed, the court agent, Mr. Victorio Venturini Medina, in the name and on behalf of Puma S.E, submitted an opposition to them.

The Parties did not request a public hearing, and the matter was scheduled for voting and decision on February 8, 2017, date on which this took place.

LEGAL GROUNDS

FIRST.- Puma SE filed a claim for civil responsibility against Mr. Miguel Temboury Redondo and Mr. Luis Ramallo García, both in their capacity of arbitrators in respect of the arbitration award issued on 2 May 2010,[1] which was set aside by a final judgment of the Provincial Court of Madrid, dated 10 June 2011, on the basis of Puma's claim of breach of the principle of arbitral collegiality, because the third arbitrator, appointed by Puma to the arbitral tribunal, Mr. Santiago Gastón de Iriarte, was excluded by the defendants when rendering the award.

Mr. Ramallo acted as chairman of the arbitral tribunal and Mr. Temboury as co-arbitrator appointed by the party opposing Puma.

[1] [Translator's Note: This date is erroneous. The arbitral award was issued on 2 June 2010.]

Said judgment expressly states the following: «On 2 June the two defendants, Mr. Ramallo and Mr. Temboury, met. As a result of this meeting, the award was notified to the parties. The president of the arbitral tribunal, Mr. Ramallo, sent a copy of the text to the third arbitrator, Mr. Gastón de Iriarte (who, as indicated, did not participate in the meeting in which the award was finalized, and to which he was not summoned, with the other members being aware that he was travelling outside Madrid), on the same day, 2 June, at 21:11, via email».

Consequently, in view of the facts declared proven by the Provincial Court, which considered that there was an undue exclusion of the third arbitrator in the deliberation of the award, the claim for civil liability against the arbitrators resulted in a judgment against each of them of 750,000 Euros, plus interest; corresponding to the amount of the fees received by each of them as arbitrators.

The claim was made pursuant to Article 21 of the Arbitration Law.

The Court of First Instance dismissed[2] the claim. Following the submission of the appeals by both defendants, the judgment of the Provincial Court of Appeal confirmed the judgment of the trial judge in full.

The judgment under appeal declares the following as proven facts:

(i) The participation of the defendants as arbitrators, together with Mr. Gastón de Iriarte, in the arbitration award rendered at the request of the trading company Puma AG RD Sport against Estudio 2000, S.A., initiated on 6 August 2009 and concluded by means of an award.

(ii) After several meetings and given the discrepancy existing between them regarding the compensation to be awarded to one of the parties, on 28 May 2010, the three arbitrators were close to reaching an agreement, which ultimately broke down at the last meeting of 31 May; Mr. Gastón sought a reduction of the amount of compensation that had been discussed.

(iii) With the full knowledge of the defendants that the latter was travelling, they met on 2 June, without summoning the third arbitrator, rendering an award in the terms in which they both agreed, and the compensation was finally fixed at 98.19 million Euros, for various concepts, which was notified to the parties on the same day. A copy was also sent to the third arbitrator, who had always attended the meetings to which he was summoned, without there being any indication that he acted to delay the

[2] [Translator's Note: So states the judgment, erroneously. The Court of First Instance accepted the claim, and the defendants appealed.]

proceedings, or to obstruct the proceedings, nor to have intervened in the decisive final discussion in which the final award was rendered.

(iv) The «final» award signed exclusively by both co-defendants stated that: *«In accordance with the terms of article 37.3 of the Arbitration Law, this award is signed by Mr. Luis Jacinto Ramallo García and by Mr. Miguel Temboury Redondo, constituting the majority of the members of the Arbitral Tribunal required by said article. The signature of Mr. Santiago Gastón is not included since he has not yet given his consent to this award, but the notification to the parties is nevertheless considered convenient to be carried out as soon as possible, in accordance with the interest expressed by them during the present arbitration».*

(v) In a judgment of 10 June 2011, issued by the 28th Section of the Provincial Court of Madrid, the arbitration award issued by the defendants on 2 June 2010 was set aside for failing to summon the arbitrator, the exclusion of the arbitrator and the defect during the making of the award.

(vi) The timeframe for issuing the award expired on the following 4 July, according to the third procedural order, without there being an urgency of the parties or need to anticipate the decision.

SECOND.- The appeals in cassation of each of the defendants are based on the same violation of Article 21 of the Arbitration Law, on the responsibility of arbitrators and arbitration institutions, which, in this regard, provides the following: «1. Acceptance obliges the arbitrators and, where applicable, the arbitral institution to comply faithfully with their responsibilities, being, if they do not do so, liable for the damage and losses they cause by reason of bad faith, recklessness or fraud. Where the arbitration is entrusted to an arbitral institution, the injured party shall have a direct action against the institution, regardless of any actions for compensation available against the arbitrators».

Several things are alleged: (1st) violation by the judgment of the doctrine contained in the judgment of 26 April 1999, since the judgment under appeal describes the conduct of the defendants as reckless, on the basis of the gross negligence of the arbitrators established in the case, without analysing the intention of the arbitrators, that is, without analysing the intentional subjective element required by the rule, and (2nd) the assimilation of recklessness to manifest, serious and inexcusable error, by citing the judgment of 20 December 2006 on the responsibility of judges and magistrates in the exercise of their functions, and the judgment of 30 May 2013 on judicial error. The

appeals in cassation allege that the arbitrators' actions were entirely protected by the doctrine established by the judgment of 21 March 1991, which dismissed an application for setting aside an award on the grounds that one of the arbitrators maintained that the other two had ignored him when rendering the Award.

Both appeals are analysed together below in order to dismiss them.

1.- As to the judgments cited in the appeals, the first one refers to the responsibility of judges and magistrates. The second, under the 1953 Arbitration Law, rules that the award was not null and void because it had been rendered by the majority. This decision-making solution is accepted by law, which is not subject to debate in the present case. The question does not revolve around whether or not it is null and void because it was adopted by a majority or by unanimity, but is rather a matter of the content and scope of the acts of the defendant-arbitrators who met on 2 June 2010 and excluded the third arbitrator, being fully aware that he was travelling. Therefore, they did not even summon him or allow him to participate in the drafting of the award, since he was the arbitrator designated by PUMA, and he did not agree with the decision of the other two who excluded him. There remained sufficient time to issue the award because the deadline was 4 July, and there was no formal record of any urgency of the parties or need to issue the decision earlier.

2.- The Arbitration Law restricts the responsibility of the arbitrators to «damages caused by bad faith, recklessness or fraud» (Article 21 Arbitration Law), considering that only damages caused intentionally or by gross negligence can satisfy the liability demanded of arbitrators without threatening the necessary freedom of action for the exercise of the heteronomous power of the resolution of conflicts in accordance with the will of the parties. Imposing on the arbitrator the damages caused by negligence that do not involve a sufficiently characterized breach of their duties is contrary to the functional autonomy protected by the parties' freedom to agree that forms the basis of this institution (judgment of 22 June 2009).

3.- Recklessness is not identified with the intention to prejudice, or with what the judgment of 26 April 1999 describes as «intentional harmful illegality», in the framework of a responsibility based exclusively on willful misconduct and negligence, in which recklessness does not have to be intentional, especially after the judgment of 22 June 2009. Recklessness is equal to an inexcusable negligence, with a manifest and serious error, without justification, that is not linked to the annulment of the award, but to

a perilous action on the part of those who know their office and should have respected it in the interest of those who entrusted them to carry out the arbitration. The conduct is of one who ignores, without respect for a minimum standard of reasonableness, the rights of those who commissioned the arbitration and the proper functions of the arbitrators; in summary, denaturalizing the course of arbitration without any possibility that the award could be properly issued, as it happened in this case, with the consequent damage. Ultimately, it was extraordinary or unforeseen conduct that is beyond the good judgment of anybody.

It is unacceptable that those who have clearly violated the rules of arbitration, then rely on them by proposing an interpretation that, if it were admitted, would invalidate the very essence of what constitutes the deliberation and decision of all the members of an arbitral or judicial tribunal, and which is inseparable from the principles of collegiality and of contradiction between all of them through the deliberation process and the taking of the responsibility for decisions when more than one arbitrator is involved, confusing the essential question of making or adopting the decision of the collegiate body, with the need to constitute a certain majority for it to take effect.

It is not possible to carry out the rule of two against one by the elimination of the third arbitrator from the deliberations and the voting, nor is it in the judgment of 21 March 1991, which has nothing to do with this case. In the judgment of 21 March 1991 there was a deliberation and vote on the award by all of them, although it was drafted by those who voted in favour, which is different from two arbitrators excluding the third one from the deliberation and vote of the award. Nor does the Law require that the arbitrators deliberate the award all together, regardless of whether there is unity of opinion.

The appealed judgment states that the essence of the formation of the will of the tribunal in the deliberation and final vote «also operates as a means of internal control of its members, and external control by its recipients, with respect to the decision adopted. In other words, it is not a case of that, once the possibility of a majority has been envisaged, or by the agreement of those who support a particular proposal or decision, the participation of the remaining members can be rejected "ad límite", since they have the right and obligation to know both the internal reasons that justified the decision and final vote –the process or development of the deliberation and arguments put forward– and the external reasons, by the positive manifestation of the specific statements, which will subsequently be reflected in the drafting and signature of the award or decision. In addition, there is an inherent power in this dissenting minority to formulate the corresponding dissenting opinion in order for the parties to have full knowledge of the decision and legal criteria taken into account for its formation by the said majority or

the disagreements of the minorities, and also to be able to exercise the corresponding actions for appeal or annulment, in the defense of their interests. Without a complete knowledge of this process, formally embodied in the decision, the Parties' possibilities are objectively diminished, as well as the legal security and transparency of the Award rendered».

4.- A proven fact of the judgment is that the third arbitrator did not obstruct or delay the proceeding, trying to persuade the others of his different position, nor did he intervene in the decisive final debate where the final award was prepared, forcing the two arbitrators to issue the award by reason of the time that had passed, given that the deliberation period between the arbitrators had not ended and that there was no urgency to issue the award.

We are not before what is known as a truncated tribunal. The truncated tribunal doctrine, according to the judgment under appeal, «has an essential purpose which is to combat intentional arrangements between an arbitrator and the party that appointed him or her; arrangements that result in the need to reappoint the arbitral tribunal by engaging a new arbitrator, which entails an objective delay and, as the case may be, the need to conduct again the proceedings before the reconstituted tribunal, on account of the strategic resignation or withdrawal of that party-appointed arbitrator».

«Consequently, it is now considered that this withdrawal of the party-appointed arbitrator, usually by agreement, with an illegitimate procedural strategy, "truncates" the existing arbitral tribunal, forcing its reconstitution or reintegration with the resulting financial losses because of the new payments that must be made, and the objective procedural delay, which entails a burden on the pending dispute and litigation. Therefore, the doctrine invoked of truncated tribunals intends to combat such maliciously agreed actions between the party and the arbitrator it designated, without being permitted the unjustified withdrawal or resignation of the arbitrator, subject, therefore, to the agreement of the parties, to the terms of the agreed arbitration rules and, failing that, to the general rule, since the arbitrator is obliged to carry out his mandate and cannot withdraw without a just cause».

None of this occurred in this case. On the contrary, Mr. Gastón did nothing to prevent the three arbitrators from deliberating, voting and issuing the award together by unanimity or by majority. A proven fact of the judgment is also that «the respondents being fully aware that the latter was travelling, met on 2 June, without summoning the third arbitrator.»

THIRD.- The appellants are ordered to pay the costs in accordance with the provisions of Articles 394 and 398, both of the Law of Civil Procedure.

DECISION

In accordance with the foregoing, in the name of the King and by the authority conferred by the Constitution, this Court has decided

To dismiss the appeals in cassation submitted by the legal representatives of Mr. Miguel Temboury Redondo and Mr. Luis Ramallo García against the judgment of Section 8 of the Provincial Court of Madrid dated 27 June 2014;[3] with the express imposition of costs on the appellants.

That the above-mentioned Court shall be provided with the corresponding certification and the return of the records and appeal file provided.

Notify this resolution to the Parties and include it in the Official State Gazette.

Agreed and signed.

[3] [Translator's Note: This date is erroneous. The judgement was dated 27 October 2014. *See* Section 3 of the Factual Background above.]