# ARBITRAL LEGITIMACY AND SPANISH FINANCIAL REGULATION

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*Resumen: Este artículo analiza las implicaciones de una serie de anulaciones de laudos arbitrales por infracción del orden público en arbitrajes de swaps (o permutas financieras) en Madrid. Comienza explicando el concepto jurisprudencial español de orden público, el cual proviene del derecho a la tutela judicial efectiva recogido en la Constitución Española y de los principios fundamentales de Derecho Europeo. Examina también los requisitos de la Directiva relativa a los mercados de instrumentos financieros (MiFID) y su implementación en la legislación española, y aborda el razonamiento jurídico de las sentencias de anulación más importantes dictadas por el Tribunal Superior de Justicia de Madrid. El Tribunal Superior de Justicia de Madrid ha anulado laudos arbitrales en base a una motivación arbitraria y a una nueva doctrina sobre orden público "económico". Hay laudos que han sido anulados por cuestiones de fondo encubiertas, y también ha habido otras decisiones judiciales que han demostrado una desconfianza por parte del sistema judicial en el arbitraje en el contexto de los swaps. El artículo sugiere que la asimetría de la información entre los bancos y los inversores, cuestión que regula la Directiva MiFID, ha sido acompañada por una asimetría procesal en la resolución de conflictos, generada por el uso por parte de los bancos de contratos de adhesión con cláusulas arbitrales. El resultado ha sido que los tribunales judiciales han impugnado la legitimidad del arbitraje en el contexto de los swaps. El artículo concluye estableciendo que cuando se produce una discrepancia entre las resoluciones de los tribunales judiciales y las de los tribunales arbitrales en disputas que son idénticas desde un punto de vista jurídico, como ha ocurrido en este caso con los swaps, la legitimidad del arbitraje se pone inevitablemente en duda.*

## A. Introduction:

We have become accustomed to criticism of investment arbitration. It is pejoratively portrayed as a privileged private forum for multinationals; as an impediment to the regulatory power of states; as undemocratic and an infringement of national sovereignty. Investment arbitration stands accused of favouring investors over States, and certain States have withdrawn from their commitments to investor-State arbitration. The European Union has proposed an investment court staffed with national judges for investor-State dispute resolution. The European commission, in a statement on a proposed EU trade agreement with Japan, stated that: *"For the EU ISDS* [Investor State Dispute Settlement] *is dead."*[2]

International commercial arbitration has not been subject to similar sustained or trenchant criticism, but nor has it been exempt from controversy. In England a speech by the Lord Chief Justice in 2016 suggested that the success of international arbitration was having some negative effects on the development of the common law, and that it was time to look again at the balance between the courts and arbitration.[3] In France, the high profile and politically controversial *Tapie* case saw the Cour de Cassation confirm the annulment of a substantial award for having been procured through the 'fraudulent collaboration' between a party, his counsel and

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2 'EU-Japan Economic Partnership Agreement: A new EU trade agreement with Japan' (European Commission, 1st July 2017), page 6; available at: http://trade.ec.europa.eu/doclib/docs/2017/july/tradoc_155684.pdf

3 Lord Thomas *LCJ Developing commercial law through the courts: rebalancing the relationship between the courts and arbitration*, The Bailii Lecture 2016, 9 March 2016, available at:

one of the arbitrators.[4] Both these examples draw attention to the role of judicial supervision of arbitration.

It is impossible to identify an optimal level of judicial supervision of commercial arbitration. Arbitral practitioners are quick to praise local courts when they refuse to interfere in the arbitral process or to annul an award, and to draw the inevitable conclusion that judicial restraint indicates that a jurisdiction is a safe choice for an international seat. Judicial restraint is equated with jurisdictional maturity and security for the purposes of international arbitration. There is however a fallacy in this popular logic: judicial restraint may simply reflect judicial indifference or ineffectiveness. The evaluation of judicial restraint or activism requires first requires an assessment of the quality and sophistication of the legislation and case law of the jurisdiction.

It also requires an assessment of the quality of the local arbitrators and arbitral awards. A lower incidence of judicial intervention might be expected in a mature arbitral jurisdiction, with established and experienced arbitrators, than in a jurisdiction where arbitration is a novelty and experience is limited and uneven. Evaluating local arbitral standards is subjective, and complicated by questions of confidentiality and professional courtesy.

Another possibility is that judicial activity might reflect novel developments or simply turbulent and uncertain times, rather than issues peculiar to international commercial arbitration. In recent years commercial arbitration has entered new fields such as corporate and testamentary arbitrations, class actions and new jurisdictional extensions, and innovation is always likely to generate applications for judicial clarifications.

Form as well as substance is also important in assessing judicial activism in arbitration. It is important for annulment judgments to be securely reasoned, temperate in tone, and minimal in their interventions. The relationship between the arbitral and judicial functions must be mutually supportive, and based on shared values. If comity is lost, arbitral credibility and legitimacy will suffer.

The purpose of this paper is to review and interpret certain recent annulment decisions on public policy grounds in swaps arbitrations in Spain. This analysis requires a preliminary explanation of the identification in Spain of public policy with 'fundamental' legal rules, which may be derived either from the Spanish Constitution or European law. It also requires an introduction to the EU Markets in Financial Instruments Directive 2004/39/EC (**"MiFID Directive"**)[5] and its implementing legislation in Spain.

https://www.judiciary.gov.uk/wp-content/uploads/2016/03/lcj-speech-bailli-lecture-20160309.pdf

4 *Tapie: the end of the affair*, Global Arbitration Review, June 30, 2016; available at: http://globalarbitrationreview.com/article/1067139/tapie-the-end-of-the-affair; Arrêt n°932 du 30 juin 2016 (15-13.755 ; 15-13.904 ; 15-14.145 ) - Cour de cassation - Première chambre civile - ECLI:FR:CCASS:2016:C100932

5 *Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC*, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32004L0039&from=en





The conclusions return to the questions of the relationship between the courts and arbitration, the importance of comity, and the legitimacy of international arbitration.

**B. Public Policy and Constitutional Rights:**

Spain has a modern Arbitration Act, based on the UNCITRAL Model Law[6]. It was enacted in 2003, and amended in 2011 principally to introduce testamentary and corporate arbitrations and to re-organize the competency of the Spanish courts in relation to the supervision and support of arbitration.[7] Jurisdiction over the appointment and challenge to arbitrators, the application for annulment, and the recognition of foreign awards was transferred to the Superior Courts of Justice of the Autonomous Regions, in order (according to the Statement of Purposes of the 2011 Act) to achieve more judicial uniformity by means of the elevation of these functions to superior collegial courts. There is no appeal from an annulment decision of a Superior Court of Justice.[8]

The Superior Court of Justice of the Region of Madrid has been the most active and controversial court, particularly in relation to its annulment decisions.

The Spanish Constitution has a fundamental role in Spanish arbitration. Part IV of the Spanish Constitution deals with the Judicial Power, and Article 117.3 attributes the exercise of jurisdictional authority exclusively to the Courts and Tribunals established by the law. Article 24.1 provides that all persons have the right to the effective judicial protection of the judges and courts in the exercise of their rights and legitimate interests, and in all cases to the right of defence. Arbitration in Spain therefore operates within a constitutional framework conferring exclusive jurisdiction over disputes on the ordinary courts, and guaranteeing a right of recourse to the ordinary courts, as well as a right of defence (that is, in common law terms, due process or natural justice).[9]

Spain's Constitutional Court has confirmed that arbitration is constitutional in Spain provided that the parties have voluntarily submitted to arbitration. The Constitutional Court has described arbitration as a 'jurisdictional equivalent' by means of which the parties can obtain the same objective as in the civil courts, na-

6 Law 60/2003 of 23 December, on Arbitration. For a review of Spanish arbitration law, including a consolidated translation of the 2003 Act and subsequent amendments (**"Arbitration Act"**) see Bernardo M. Cremades & David J.A. Cairns National Report-Spain in The ICCA International Handbook on Commercial Arbitration (Kluwer Law International, 2017) Supplement Nº 93, February 2017. For a comparison of the original Act with the UNCITRAL Model Law see David J.A. Cairns The Spanish Application of the UNCITRAL Model Law on International Commercial Arbitration (2006) 22 Arbitration International 573-595.

7 Law 11/2011 of 20 May, on the reform of Law 60/2003 of 23 December, on Arbitration and on the regulation of institutional arbitration in the General Administration of the State (**"2011 Act"**).

8 Art. 42.2 Arbitration Act.

9 See generally Bernardo M. Cremades El Arbitraje en la Doctrina Constitucional Española (2006) Lima Arbitration Nº 1, 185-220; Marta García Pérez, El arbitraje y la Constitución española de 1978. Una reflexión desde el Derecho público in Los retos del Poder Judicial ante la sociedad globalizada: Actas del IV Congreso Gallego de Derecho Procesal (I Internacional), A Coruña, 2 y 3 de junio de 2011; coord. por Ana Neira Pena, Agustín-J. Pérez-Cruz Martín, Xulio Ferreiro Baamonde, 2012, págs. 435-450.

mely, a decision that terminates their dispute with all the effects of *res judicata*.[10] It is a commonplace that consent is the basis of the jurisdiction of an arbitral tribunal; in Spain consent is also the indispensable foundation of the constitutional legitimacy of the exercise of that jurisdiction.

The Constitutional Court has reconciled arbitration with the exclusive jurisdiction of the ordinary courts on the basis that arbitration is an exercise of personal autonomy which itself has constitutional recognition as Article 1.1 of the Spanish Constitution defines Spain as a democratic state of law, and identifies freedom as a superior value of the legal system. In the exercise of their freedom, the parties can submit a dispute to arbitration without any violation of their constitutional right to effective judicial protection.[11]

Nevertheless, the jurisdictional implications of arbitration require that the constitutional rights of the parties of recourse to the courts and to due process be guaranteed. Therefore, the award must be subject to the supervisory jurisdiction of the courts through the action of annulment. Further, the arbitrators must at all time respect the right of defence, as defined in Spanish constitutional law, and if they do not then the parties have a right of recourse to the ordinary courts. This right of recourse is exercised through the action of annulment, and so a breach of the right of defence guaranteed by Article 24.1 of the Spanish Constitution will result in the annulment of the award.

The constitutional guarantee of the right of defence means that provisions of the Arbitration Act that deal with due process have not only an immediate procedural significance as the arbitration progresses, but also a supervening constitutional significance that might manifest itself in annulment proceedings. This applies, for example, to Article 24.1 of the Arbitration Act that requires the arbitrators to treat the parties with equality and allow them a sufficient opportunity to present their cases. The scope of this obligation is defined by Spanish constitutional law. Similarly, the requirement in Article 37.4 of the Arbitration Act that an award be reasoned, imports into arbitral practice the ample constitutional jurisprudence relating to the adequacy of reasons. In both cases, a violation of the requirements of constitutional law is challenged through the action of annulment.

The reasoning requirement means that an award must state sufficient facts and reasons to demonstrate the grounds of the decision, and must be based on legal rules. Reasons alone are not sufficient; the reasons must have legal content and not be arbitrary.[12] An arbitral award may be annulled for breach of public policy where there are no reasons, or the reasoning is capricious, a mere appearance, or expresses an irrational or absurd deductive process. Although examination for arbitrariness should not involve reconsideration of the merits, the premises and reasoning of an award have on recent occasions been examined in extensive detail.[13]

10 Judgment 15/1987 of the Constitutional Court.

11 Judgment 176/1996 of the Constitutional Court fundamento Juridico 4, referring to the function of arbitration *"como medio heterónomo de arreglo de controversias que se fundamenta en la autonomía de la voluntad de los sujetos privados; lo que constitucionalmente le vincula con la libertad como valor superior del ordenamiento (art. 1.1 C.E.). De manera que no cabe entender que, por el hecho de someter voluntariamente determinada cuestión litigiosa al arbitraje de un tercero, quede menoscabado y padezca el derecho a la tutela judicial efectiva que la Constitución reconoce a todos."*

12 In its judgment 263/2015 of 14 December 2015 the Spanish Constitutional Court describes the duty to give reasons in the following terms (author's translation; case citations omitted): *"It is necessary to remember that even though the rights and guarantees provided in art. 24* [of the Spanish Constitution] *do not guarantee the justice of the decision or the legal correctness of the proceeding or interpretation carried out by the judicial organs, as a right to correctness does not exist, nor do they ensure the satisfaction of the claim of any party to the proceeding, what they do ensure in any case is the right to have the claims developed and recognized in the proceeding established for this purpose, in compliance with the constitutional guarantees that allow the right of defense, and to conclude the proceeding with a decision based on Law, which may be favorable or adverse to the claims made…Article 24 of the Constitution imposes on the judicial organs the obligation to issue decisions based on Law, and this requirement cannot be considered fulfilled by the mere issuance of a declaration of will in one sense or another, but must be the consequence of a rational exegesis of the legislation and not the result of arbitrariness. It is not enough, therefore, to obtain a reasoned decision, but, in addition, it must have legal content and not be arbitrary. A judicial decision can be termed arbitrary when, although there is a formal line of argument, this is not an expression of the administration of justice, but rather a simple appearance because it is the result of mere judicial will or expresses an irrational or absurd deductive process….."* Cf. Article 218 of the Spanish Civil Procedure Act, which defines the legal requirements of judgments in the Spanish civil courts.





Article 41 of the Arbitration Act provides for the grounds of annulment, following in general terms the annulment scheme of the UNCITRAL Model Law. However, there is not always a comfortable correlation between these grounds of annulment and the Spanish conception of the right of defence or due process, with the result of an over-reliance in Spain on the public policy ground of annulment. In effect, any award found to infringe the right of defence guaranteed by Article 24.1 of the Spanish Constitution is ipso facto contrary to Spanish public policy and will be annulled.

### C. Public Policy and 'Fundamental' Rules of European Law:

The public policy ground for annulment not only has to accommodate the requirements of Spanish constitutional law; Spanish public policy must also recognize certain fundamental legal rules of European law.[14]

The starting point for discussion of European law and the public policy of Member States is the well-known decision of the Court of Justice of the European Union in Eco Swiss China Time Ltd v Benetton International NV (**"Eco Swiss"**).[15] The Court in Eco Swiss noted that Article 85(1) of the EC Treaty (prohibiting anti-competitive agreements) *"constitutes a fundamental provision which is essential for the accomplishment of the tasks entrusted to the Community and, in particular, for the functioning of the internal market". "It follows"*, the Court went on, *"that where its domestic rules of procedure require a national court to grant an application for annulment of an arbitration award where such an application is founded on failure to observe national rules of public policy, it must also grant such an application where it is founded on failure to comply with the prohibition laid down in Article 85(1) of the Treaty." It also stated for good*

13 See, for example, *Dexia Credit Local, S.A. v. Banco Sabadell SA* Superior Court of Justice of Madrid, 14 March 2016; *Transportes Juan Jose Gil SL v. Banco Bilbao Vizcaya Argentaria* S.A. Superior Court of Justice of Madrid, 3 November 2015.

14 On EU law and international arbitration generally, see George A. Bermann *Navigating EU Law and the Law of International* Arbitration Arbitration International, Volume 28, Issue 3, 1 September 2012, Pages 397–446,

15 Judgment of the Court of 1 June 1999. Case C-126/97; ECLI:EU:C:1999:269.

*measure that "the provisions of Article 85 of the Treaty may be regarded as a matter of public policy within the meaning of the New York Convention."*[16]

The reasoning is straightforward: an arbitral award that contravenes a fundamental provision of EU law should be annulled on public policy grounds by the courts of the Member States. This simple statement of principle conceals many thorny issues: do all violations of a fundamental provision require annulment and, if not, what is the standard to distinguish annullable from acceptable violations of competition law? Was it necessary for the parties to raise the competition law issue in the arbitration in order to justify annulment? Should arbitral tribunals raise competition law issues *sua sponte* in arbitral proceedings? Many of these issues have been addressed by the courts of the Member States since *Eco Swiss*.[17]

However, the greatest uncertainty arising from Eco Swiss was what other provisions of EU law are so fundamental that their non-compliance requires the annulment of arbitral awards on public policy grounds? Two references from Spanish courts arising from arbitration clauses in telecommunications contracts made clear that EU Directive 93/13 on unfair terms in consumer contracts was of such a mandatory character. In *Elisa María Mostaza Claro v Centro Móvil Milenium SL* ("**Mostazo Claro**")[18] the First Chamber of the Court identified the 'mandatory' and 'essential' nature of this EU consumer protection legislation:[19]

> *"36. The importance of consumer protection has in particular led the Community legislature to lay down, in Article 6(1) of the Directive, that unfair terms used in a contract concluded with a consumer by a seller or supplier 'shall ... not be binding on the consumer'. This is a mandatory provision which, taking into account the weaker position of one of the parties to the contract, aims to replace the formal balance which the latter establishes between the rights and obligations of the parties with an effective balance which re-establishes equality between them.*
>
> *37. Moreover, as the aim of the Directive is to strengthen consumer protection, it constitutes..... a measure which is essential to the accomplishment of the tasks entrusted to the Community and, in particular, to raising the standard of living and the quality of life in its territory (see, by analogy, concerning Article 81 EC, Eco Swiss, paragraph 36)."*

Given the importance of consumer protection, a court seised of an action for annulment of an arbitral award *"must determine whether the arbitration agreement is void and annul that award where that agreement contains an unfair term, even though the consumer has not pleaded that invalidity in the course of the arbitration proceedings, but only in that of the action for annulment."*[20]

16 Ibid, paragraphs 36, 37 and 39.

17 The Paris court of Appeal in *Thalès Air Defence BV v. GIE Euromissile CA Paris, November* 18, 2004. decided that to set aside an award for breach of international public policy-including a violation of EU competition law- the violation must be 'blatant, actual and concrete', and that the court's power of review for breach of public policy was not limited to issues raised before the Arbitral Tribunal: see generally Denis Bensaude *Thalès Air Defence BV v. GIE Euromissile: Defining the Limits of Scrutiny of Awards Based on Alleged Violations of European Competition Law* (2005) Volume 22 Journal of International Arbitration 239; Santiago Martínez Lage Arbitration and EU competition law: new rulings and new thoughts. Spain Arbitration Review – Revista del Club Español del Arbitraje 25/2016 119-145; George A. Bermann Navigating EU Law and the Law of International Arbitration Arbitration International, Volume 28, Issue 3, 1 September 2012, Pages 397–446, at 424-428,

18 Judgment of the Court (First Chamber) of 26 October 2006; ECLI:EU:C:2006:675

19 *Mostazo Claro*, paragraphs 36 and 37.





In *Asturcom Telecomunicaciones SL v Cristina Rodríguez Nogueira* ("**Asturcom**")[21] the First Chamber, concluded that a breach of EU Directive 93/13, given its essential nature as identified in Mostaza Claro, justified the refusal of enforcement of the award on public policy grounds:

> *"52. Accordingly, in view of the nature and importance of the public interest underlying the protection which Directive 93/13 confers on consumers, Article 6 of the directive must be regarded as a provision of equal standing to national rules which rank, within the domestic legal system, as rules of public policy.*
>
> *53. It follows from this that, inasmuch as the national court or tribunal seised of an action for enforcement of a final arbitration award is required, in accordance with domestic rules of procedure, to assess of its own motion whether an arbitration clause is in conflict with domestic rules of public policy, it is also obliged to assess of its own motion whether that clause is unfair in the light of Article 6 of that directive, where it has available to it the legal and factual elements necessary for that task ....."*

### D. MiFID Directive and its Implementation in Spain:

The EU Markets in Financial Instruments Directive 2004/39/EC ("**MiFID Directive**")[22] entered into force in November 2007. The MiFID Directive is a comprehensive regulation for European financial markets. It includes investor protection provisions covering such matters as the obligation of investment firms to act 'honestly, fairly, and professionally in accordance with the best interests of its clients' and to provide 'fair, clear and not misleading' information, to provide appropriate information in a comprehensible form to clients, and to provide investment advice appropriate to the client's knowledge and experience in the investment field.[23] The 2008 financial crisis immediately tested the MiFID Directive and its implementation in the legislation of Member States.[24]

The MiFID Directive was followed by *Commission Directive* 2006/73/EC ("**MiFID Implementation Directive**).[25] Articles 35-37 of the MiFID Implementation Directive provided for two distinct types of client risk assessments by investment firms called respectively 'assessment of suitability' and 'assessment of appropriateness'.

20 *Mostazo Claro*, paragraph 39.

21 Judgment of the Court (First Chamber) of 6 October 2009; ECLI:EU:C:2009:615.

22 *Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, available at:* http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32004L0039&from=en

23 MiFID Directive Preamble 31 (*"One of the objectives of this Directive is to protect investors....."*) and Article 19.

24 In June 2014, the European Commission adopted new rules revising the *MiFID framework comprising the Markets in Financial Instruments (MiFID II) - Directive 2014/65/EU, and Markets in Financial Instruments (MiFIR) - Regulation (EU) No 600/2014.*

25 *Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, available at:* https://publications.europa.eu/en/publication-detail/-/publication/d9b930d3-0bd0-4376-ae11-2822a3433242/language-en

The Spanish implementation of the MiFID Directive included amendments to securities legislation (specifically amendments to the Ley de Mercado de Valores ("**LMV**") and a new Royal Decree 217/2008 in relation to investment service providers).[26] Art. 78bis.1 of the LMV required investment services providers to classify their clients into two classes: professional clients and retail clients. It defined professional clients, and Art. 78bis.4 deemed all clients to be retail clients except for investment professionals.

Art. 79bis of the LMV defined the information obligations of investment service providers. Investment information was required to be fair, clear and not misleading. It was also required to include sufficient information to enable the client to understand the nature and risks of the investment service and of the specific type of financial instrument that was being offered so as to enable the client to take investment decisions on an informed basis.[27]

Art. 79bis distinguished between investment advice and other services (which included execution-only services). Art. 79bis also identified the information financial services providers were required to obtain from their clients, which was elaborated by regulation in Royal Decree 217/2008. Articles 72-74 of Royal Decree 217/2008, following the MiFID Implementation Directive, distinguished, between the suitability and appropriateness risk assessment required by financial services providers:

(i) The suitability assessment (evaluación de la idoneidad), applicable to investment advisory services, required the financial institution to obtain sufficient information to ensure their recommendations met the investment objectives of the client, and that the client could assume the risks of the investment;

(ii) The less demanding appropriateness assessment (evaluación de la conveniencia), applicable to other services, required the financial institution to ensure that the client had the knowledge and experience necessary to understand the risks of the product.

The financial crisis generated a significant volume of disputes relating to the misspelling of financial products offered by Spanish financial institutions to retail investors, including swaps. One study provides figures for the number of judgments and success rates for retail clients on appeal from decisions at first instance in swaps cases:[28]

26 Ley 24/1998 de 28 de julio, del Mercado de Valores; *Real Decreto 217/2008, de 15 de febrero, sobre el régimen jurídico de las empresas de servicios de inversión y de las demás entidades que prestan servicios de inversión.* This securities legislation has now been consolidated: see *Real Decreto Legislativo 4/2015, de 23 de octubre, por el que se aprueba el texto refundido de la Ley del Mercado de Valores.*

27 Art. 79bis.2 and .3 LMV (cf Art. 19.2 and 19.3 MiFID Directive).

28 See table 2.1 *'Comparativa de resoluciones sobre swaps in AAPP 2012-2015'*, Jausas Legal y Tributario SLP *Observatorio de la Jurisprudencia de productos financieros complejos, Año 2015* page 10 (figures derived from the Westlaw database of Spanish judgments for the Audiencias Provinciales, where cases go on appeal after a decision at first instance); available at: http://www.jausaslegal.com/observatorio-de-la-jurisprudencia-de-productos-financieros-complejos-2015/





(i) In 2013, there were 900 appeal judgements involving swaps, with a success rate for retail clients of 70.55%;

(ii) In 2014 there were 1,057 appeal judgements involving swaps, with a success rate for retail clients of 74.17%;

(iii) In 2015 there were 733 appeal judgements involving swaps, with a success rate for retail clients of 82.5 %.

These figures are dominated by a reduced group of leading banks, with Banco Santander, Spain largest bank, comprising 38.07% of a sample of 415 judgments. Spain's second and third largest banks, Banco Bilbao Vizcaya Argentaria S.A. ("**BBVA**"), and Caixabank, made up no more than approximately 7% each of the sample, with the study qualifying these figures by noting that 'both BBVA and Caixabank rely on arbitration clauses in the majority of their contracts'[29].

In the important judgment in *Marbres Togi S.L. v Caixa d'Estalvis del Penedés* ("**Togi**")[30] of January 20, 2014 the Spanish Supreme Court considered the legal consequences of a bank's failure to perform the suitability assessment, or to properly inform the client of the risks of a commodities swap contract. The Supreme Court noted the importance of the information obligation[31], reasoned that the information required by Art. 79bis LMV was indispensable in order for a retail investor to validly consent to the contract, so that the client that entered into the contract without knowledge of the risks of the product was acting under a fundamental mistake, and the swaps contract was accordingly void. [32] There followed numerous other judgments applying these principles to the facts of particular swaps contracts.

As noted above, two of Spain's leading banks included arbitration clauses in most of their swaps contracts, usually in the standard form Framework Agreement on Financial Transactions (*Contrato Marco de Operaciones Financieras or CMOF*).[33] The volume of disputes meant that there were multiple arbitrations raising similar issues, administered by a reduced group of institutions, and where the banks often appointed the same arbitrators in multiple cases. Arbitral tribunals, like the courts in similar cases, had to deal with the submission that the financial institution had not performed the appropriate assessment, or had properly informed clients of the risks associated with swaps products.

29 *Ibid,* page 9.

30 Judgment 840/2013 of the Supreme Court, 20 January 2014.

31 The Court referred to the complexity of financial products, the 'information asymmetry' at the time of contracting, and the need to protect the investor, relating the MiFID duty to provide information to the duty of contractual good faith in Spanish and European law: *Togi,* paragraph 6.

32 Togi, paragraphs 10-12. The Supreme Court also noted that although the omission of the suitability assessment did not of itself mean that a client lacked knowledge of the risks of a swaps contract, it did create a presumption of a lack of sufficient knowledge (paragraph 14).

33 On these framework agreements see Pilar Perales Viscasillas Arbitraje financiero: el sometimiento a arbitraje, Spain Arbitration Review, 24/2015 pages 9-34; The Asociación Española de Banca ("AEB") has a model framework agreement, based on the model of the International Swaps and Derivatives Association. Annex 1 to this model, entitled optional clauses, has model jurisdiction clauses, including model arbitration clauses. The model framework agreement and Annex 1 are available on the website of the AEB at: https://www.aebanca.es/es/Deinteressectorial/ContratoMarcodeOperacionesFinancieras/index.htm

The awards in these arbitrations found their way before the Spanish courts in annulment proceedings. Jurisdiction over annulment applications rests with the regional Superior Courts (*Tribunales Superior de Justicia*). The most active court has been the Superior Court of Madrid, where the rates of annulment have been high, and the reasoning of the courts often unsettling for the arbitral community. Between January 1, 2012 and December 31, 2016 BBVA was the respondent in thirteen annulment proceedings arising from swaps arbitrations. Eight of the thirteen awards in these proceedings were annulled, an annulment rate of 61.54%.

### E. 'Arbitrariness' and 'Economic' Public Policy in Swaps Arbitrations:

The reasoning of the Superior Court of Madrid in the swaps cases is well illustrated by the leading judgement in *Repos i Repàs, S.L. v BBVA* ("**Repos**").[34] It is important to consider the facts and reasoning in this annulment decision in some detail, as it demonstrates an approach repeated in subsequent annulment decisions, and provides an excellent platform to identify the disturbing issues raised by this line of annulment cases.

The Claimant in Repos requested the nullity of a CMOF or framework contract and an associated interest rate swaps contract. The arbitral tribunal rejected this claim and found for BBVA. The claimant sought the annulment of the award on public policy grounds, alleging that BBVA had not complied with its obligations under the LMV, and related norms.[35]

The judgment in the Superior Court of Madrid enables the identification of certain key factual findings and legal conclusions made by the arbitral tribunal:

> (i) The Claimant approached BBVA to unify various credits with the bank, and also asked for a product that would avoid variations in the interest rate payable by the Claimant. BBVA responded by offering an interest rate swap, indicating that this product was ideal for stabilising the financial costs of the firm;[36]
>
> (ii) The interest rate swap was not a product of particular complexity;

34 Superior Court of Justice of Madrid, 28 January 2015; judgment 13/2015.

35 *Repos,* Fundamentos Jurídicos Primero y Cuarto.

36 *Repos,* Fundamento Jurídico Sexto, 1º fourth paragraph: *"En el curso de la negociación con la Demandada, la Demandante, por medio del Sr. Julio , expuso su preocupación por la coyuntura de subida de tipos de interés y se interesó por si había algún producto que le cubriera de las subidas de tipos para no tener sorpresas de un año a otro con sus costes financieros. La Demandada le ofreció entonces la suscripción de una permuta de tipos de interés, indicándole dicho producto como idóneo para estabilizar el coste financiero de su empresa."* See also Fundamento Jurídico Séptimo, fourth paragraph: *"En este sentido, el propio laudo establece (§ 2, FJ 7) que " resulta determinante la claridad del testimonio del Sr. Julio [El Administrador del Demandante] quien en el acto de la vista fue meridiano al señalar que su principal preocupación al tiempo de contratar la operación era eliminar el riesgo de las eventuales subidas de tipos, y asegurarse de que los costes financieros fueran siempre estables, ' pues no quería sorpresas ".*





> (iii) The Award found that BBVA applied the test of appropriateness (conviviencia) and was not obliged to apply the test of suitability (idonedad)[37];
>
> (iv) In applying the test of appropriateness, BBVA considered the personal circumstances of the Claimant's administrator, who the Tribunal found had knowledge and experience of financial products which required that he exercise a higher level of care than an ordinary consumer;[38]
>
> (v) The Arbitral Tribunal did not make any express finding over the provision of information by BBVA regarding the costs of cancellation, instead finding the Claimant knew that it was contracting a product of 13 years duration;
>
> (vi) The information provided by BBVA was not misleading in any way[39];
>
> (vii) Indeed, the evidence from a recorded telephone conversation confirmed that the Claimant's administrator understood the product contracted.

The Superior Court of Justice of Madrid noted the established case law that an annulment is not an appeal, and that annulment is limited to the grounds set out in the Arbitration Act[40]. Turning to the public policy ground, the Superior Court of Madrid stated that public policy included the fundamental rights and liberties protected by the Constitution as well as imperative norms of European law *"that are now known as 'economic public policy' which includes certain basic rules and irrevocable principles of contracting in circumstances of special seriousness or singularly necessary of protection"*, referring to the jurisprudence of the European Court and specifically to Eco Swiss, and also to the Supreme Court decision in Togi. By associating *Eco Swiss* and Togi in this way, the Togi decision was raised from a definitive determination of Spanish law (an error in regard to which by an arbitral tribunal is not a ground for annulment), to a rule 'fundamental for the functioning of the market whose breach justifies annulment or the non-recognition of an award'. The basis of this principle, according to the Superior Court and referring explicitly to Togi, was contractual good faith, the breach of which was especially reprehensible in a contractual situation of 'desequilibrium, disparity or asymmetry between the parties by

37 Repos, Fundamento Jurídico Sexto; Fundamento Jurídico Séptimo, third paragraph *"El propio laudo así lo reconoce….que 'consta acreditado que se hizo el test de conveniencia' y que 'la demandante no estaba obligada a realizar el test de idoneidad'." "El laudo, como hemos visto, considera suficiente ese test y excluye la pertinencia del de idoneidad (§ 15, FJ 5), cuando pondera el cumplimiento por BBVA de sus obligaciones de información."*

38 Repos, Fundamento Jurídico Séptimo, second paragraph.

39 *Repos,* Fundamento Jurídico Séptimo: "Así en el § 23 [del Laudo] se advierte que se *"aportó una información clara, veraz, imparcial y no engañosa a la demandante para que, con una mínima diligencia, fuera consciente de los elementos esenciales del producto que estaba contratando, en virtud del cual, tal y como le indicó Don. Andrés ' Sería equivalente a decir que usted tiene un tipo fijo para el préstamo del 5,29 % (ya que el Euribor que paga el cliente al Banco se compensa con el Euribor que recibe el cliente del Banco)'"*

40 *Repos,* Fundamento Jurídico Cuarto.

reason of the complexity of the product and the disparate knowledge of the contracting parties'.[41]

Turning to the facts of the case, the Superior Court of Madrid began by recording *"obvious errors of law, manifest in the award, that contravene the legislation"* as well as *"omissions in reasoning equally obvious,"*[42]including the following:

> (i) This was clearly a case of investment advice to a retail client and so the test of suitability (and not mere appropriateness) applied. Nevertheless, the arbitral tribunal had found that an appropriateness assessment had been performed, and that BBVA was not required to perform the suitability test. In this respect, the award had an obvious error in respect of a basic element relating to the information obligation, and therefore was constitutionally invalid by reason of its arbitrariness;[43]
>
> (ii) The award found that the swaps contract was 'not particularly complex', while the LMV specifically prohibited that a swaps contract be considered non-complex;[44]
>
> (iii) the award stated that it was 'obvious' that the swaps contract did not provide for early cancellation, and entirely overlooked the obligation of the bank to inform the client regarding the possibility of early cancellation and the costs that this involved.[45]

The judgment concluded that the finding in the award that there was no mistake by the investor sufficient to vitiate the contract was based on the obvious breach of mandatory rules, and that these breaches of mandatory rules meant that the reasoning of the award was arbitrary.[46] The Court said that it was not its function to decide whether the contract was void for mistake and lack of consent; however, the award was annulled for being contrary to public policy, as the reasoning was arbitrary, in violation of the right of defence guaranteed by Article 24.1 of the Spanish Constitution, in that it was manifestly contrary to mandatory legal rules. In addition, the importance of these mandatory rules as an expression of contractual good

41 *Repos*, Fundamento Jurídico Cuarto.

42 *Repos*, Fundamento Jurídico Sexto, second paragraph: *"Comencemos constatando….. lo que son errores de Derecho ostensibles, manifiestos del laudo impugnado, por contravenir la Ley. Consignaremos también omisiones de motivación igualmente patentes."* For discussion of this point, and errors made by the Superior Court, see Manuel Conthe *Swaps de Intereses: la sentencia del TSJ de Madrid de 28 de enero de 2015, La Ley, nº 8515, jueves 9 de abril de 2015*, pgs. 1-8

43 Repos, Fundamento Jurídico Sexto, 1º, final paragraph: *"Es así manifiesto, patente sin necesidad de elucubración alguna, que el laudo yerra en la calificación jurídica que constituye el presupuesto básico para determinar el alcance de los deberes de información que le eran imputables a la entidad financiera oferente del swap. Ese yerro patente es, en sí mismo, expresión de la arbitrariedad constitucionalmente proscrita* (art. 24.1 CE )."

44 *Repos*, Fundamento Jurídico Sexto, 2º.

45 *Repos*, Fundamento Jurídico Sexto, 3º.

46 Repos, Fundamento Jurídico Octavo: *"En definitiva: el laudo asienta su decisión sobre la base de la infracción legal patente de normas imperativas: de un lado, un error grosero de calificación sobre los deberes de información de BBVA al no realizar el test de idoneidad y, pese a ello, calificar el swap de idóneo para REPOS I REPAS; y, de otro lado, dar por buena, contra legem, la omisión de información precisa sobre costes y riesgos de la operación por no reputar el producto como complejo. Estas contravenciones patentes de normas imperativas hacen que la motivación del laudo sea arbitraria: los presupuestos jurídicos sobre los que se asienta el fallo son tan ostensiblemente errados que vician de raíz la motivación que se erige en ratio decidendi del laudo."*





faith was a question of public policy that provided an additional basis of annulment.[47]

Accordingly, two breaches of public policy were ultimately relied upon: the breach of the right of defence guaranteed by Article 24.1 of the Spanish Constitution, and secondly, the violation of the 'economic public policy' identified with the policy objectives of MiFID and LMV of contractual good faith, and the protection of retail investors. A breach of the right of defence by reason of arbitrariness was an established ground of public policy based on Spanish Constitution. The breach based on 'economic public policy was a new extension of public policy, based in European law and derived from *Eco Swiss*.

From an arbitral perspective, this judgment requires a number of comments:

> (i) Notwithstanding the Superior Court's protestations to the contrary, the award was clearly annulled on the merits. The fact that the Superior Court avoided a pronouncement of the ultimate issue of whether the contract between the Claimant and BBVA was void for mistake, and framed its decision in the language of constitutional doctrine and fundamental law, does not disguise that the Superior Court identified basic factual and legal errors affecting the merits, and annulled the award on the basis of these errors;
>
> (ii) The doctrine that arbitrary reasoning justifies annulment is only defensible where the doctrine is narrowly confined. It is relatively easy, for a determined judge, to reframe a disputable finding of fact or law as an error in reasoning;
>
> (iii) The doctrine that certain EU laws are fundamental, and therefore any decision inconsistent with these laws is annullable, is a thinly disguised justification for annulment on the merits. This doctrine now has the name 'economic public policy', and might be extended whenever an annulment court is faced with an award that combines issues of EU law, contractual good faith and disequilibrium, disparity or asymmetry between the parties;
>
> (iv) Finally, the award was annulled notwithstanding the Arbitral Tribunal's findings that the Claimant had sought a product with the characteristics of an interest rate swap, understood the product and its risks, and had not been deceived in any way by BBVA. The annulment decision also relied significantly on Togi for the correct statement of the law, even though this Supreme Court decision was handed down after the issue of the award.[48]

47 *Repos*, Fundamento Jurídico Octavo: *"En estas circunstancias, la Sala hace ver la necesidad de tener presente que, en este ámbito de enjuiciamiento, no tiene por qué incidir, ni incide, en si el contrato debió ser anulado o no en función de un error esencial de consentimiento: su objeto de análisis es el laudo, cuya motivación contraviene el orden público por arbitraria, ex art. 24.1 CE , en el sentido de manifiestamente contraria a reglas legales imperativas; como sucede que, además, esas normas de ius cogens son expresión del principio general de buena fe contractual, y este principio, muy señaladamente en este tipo de contratos y con esta clase de contratantes …. es cuestión de orden público, también se aprecia la causa de anulación del art. 41.1.f) LA por esta circunstancia añadida."*

48 The award was issued on January 14, 2014, and the Supreme Court judgment in *Togi v Caixa Penedés* on January 20, 2014.

The Repos decision attracted considerable commentary from the Spanish arbitral community, almost all negative.[49] There is a general consensus that the award was annulled on the merits, and is indefensible for that reason. The Superior Court of Madrid has departed from its previous jurisprudence respectful of the limits of annulment. On the other hand, the new criteria have so far been confined to domestic swaps cases, where there is a strong policy favouring the protection of retail clients. The new doctrine has not yet been applied to an international arbitral award, and hopefully will be confined to domestic securities arbitrations.[50]

The decision is clearly a judicial reaction to the financial crisis in Spain, and the voluminous litigation arising from the scandalous mis-selling of financial products, and not just swaps, to retail investors. Financial arbitration in Spain has found itself in the eye of a hurricane, and the Repos judgment in this context has been defended in these terms:[51]

> *"The image of our financial sector is badly damaged as a result widespread unprofessional conduct, in which neither the entities nor the regulators have lived up to expectations. The fact that the courts act and apply MiFID for what it is (a protective regulation) helps to restore the confidence of domestic and foreign investors. It is good for transparency and market unity to know that in Spain there are not two separate systems (judicial and arbitral) in which the rules of public policy are applied differently.*
>
> ....
>
> *In our opinion, the judgment of the Superior Court of Madrid could have a beneficial effect for arbitration. The annulment action is designed by the Legislature as an instrument that avoids the total independence of the arbitration system from the Courts. The fact that the courts exercise their control function is positive for financial arbitration. In a mature market, what drives an investor away is not the application of the rules, but their lack of application. The risk of annulment has a healthy disciplining effect on arbitrators, as it forces them to be very rigorous in applying MiFID and in following the doctrine of the European Court and the Supreme Court. The rules of public policy apply equally in all areas of justice. This preserves confidence in the system and reinforces arbitration as a means of alternative dispute resolution."*

49 There is a spirited defence of the Repos decision by the lawyers for the applicant: see Pablo Franquet and Jordi Ruiz de Villa ¿Efecto Mariposa?: *Nulidad de Laudo Sobre un Swap por Vulneración del Orden Público,* available at: http://www.jausaslegal.com/efecto-mariposa-nulidad-de-laudo-sobre-un-swap-por-vulneracion-del-orden-publico/

50 There are many commentaries on the Repos decision and its implications. The following are particularly useful: Pilar Perales Vascasillas *Anulación de laudos sobre contratos de permuta financiera (SWAP) por el Tribunal Superior de Justicia de Madrid,* Diario La Ley, nº 8700, February 2016, pages 1-5; Manuel Conthe *Swaps de Intereses: la sentencia del TSJ de Madrid de 28 de enero de 2015,* La Ley, nº 8515, jueves 9 de abril de 2015, pgs. 1-8; Pascual Sala Sánchez, *'El principio de mínima intervención judicial en el arbitraje y sus principales manifestaciones',* Arbitraje: Revista de Arbitraje Comercial y de Inversiones, 2016, Volume 9 Issue 2, pp. 333 – 367; José Carlos Fernández Rozas *Riesgos de la heterodoxia en el control judicial de los laudos* Diario La Ley 3266/2015; 12 de mayo de 2015; José Manuel Suárez Robledano, *'Hacia un concepto único del orden público en el arbitraje: la seguridad jurídica',* Arbitraje: Revista de Arbitraje Comercial y de Inversiones, 2016, Volume 9 Issue 2) pp. 435-458.

51 Pablo Franquet and Jordi Ruiz de Villa ¿Efecto Mariposa?: *Nulidad de Laudo Sobre un Swap por Vulneración del Orden Público,* supra, my translation; the original Spanish reads: *"La imagen de nuestro sector financiero está muy dañada como consecuencia de una situación de mala praxis generalizada, en la que ni las entidades ni los supervisores han estado a la altura. El hecho de que los tribunales actúen y apliquen MiFID como lo que es (una normativa protectora) ayuda a recuperar la confianza de los inversores nacionales y extranjeros. Es bueno para la transparencia y la unidad de mercado que se sepa que en España no existen dos sistemas separados (judicial y arbitral) en que las normas de orden público se aplican de forma distinta... En nuestra opinión, la sentencia del TSJM puede tener un efecto beneficioso para la institución arbitral. La acción de anulación está diseñada por el legislador como un instrumento que evita la total emancipación del sistema arbitral respecto de la Jurisdicción. El hecho de que los tribunales ejerzan su función de control es positivo para el arbitraje financiero. En un mercado maduro, lo que ahuyenta al inversor no es la aplicación de las normas, sino su falta de aplicación. El riesgo de anulación tiene un saludable efecto disciplinante sobre los árbitros, ya que les obliga a ser muy rigurosos en la aplicación de MiFID y en el seguimiento de la doctrina del TSJUE y del Tribunal Supremo. Las normas de orden público se aplican de igual forma en todos los ámbitos de la justicia. Ello preserva la confianza en el sistema y refuerza el arbitraje como vía de resolución alternativa de conflictos."*





On the other hand, a distinguished commentator on the Repos judgment has pointed to the dangers of 'judicial populism' in the wake of the financial crisis. *"This 'populism' of the Superior Court's judgment undermines, with rhetorical arguments not appropriate to the specific case, the arbitral system, and the right to effective judicial protection, a right that our Constitution recognizes not only for citizens and small businesses, but also for financial institutions."*[52]

The protests of the arbitration community did not temper the enthusiasm of the Superior Court of Madrid for its novel doctrine. The doctrine of 'economic public policy' has now been applied to annul awards in eight Madrid swaps cases (including Repos).[53] It creates significant practical difficulties for arbitrators in swaps cases, including the need to demonstrate in their awards their great care in the assessment of evidence and application of the law, the need to ensure consistency between their arbitral award, their assessment of the evidence, and the voluminous judicial decisions interpreting and applying the same rules, and the need to meet ever more demanding standards of reasoning for their awards, all beneath the shadow of a hostile annulment process.

### F. Arbitral Repeat Players in Swaps Arbitrations:

Article 14 of the Spanish Arbitration Act deals with arbitral institutions. Article 14.3 provides that arbitral institutions shall oversee compliance with the requirements 'as to the capacity of the arbitrators and the transparency of their appointment, as well as their independence.'

The multiple arbitrations involving swaps have also given rise to annulment applications based on conflicts of interest. In *Bajoz Eólica S.L. v. Caixabank,* S.A.[54] (**"Bajoz"**) the Superior Court of Madrid annulled an award where the arbitral institution had failed to disclose its relationship with a multiple user of its services. The applicant alleged that the Tribunal Arbitral de Barcelona (**"TAB"**) derived a substantial part of its income from arbitrations over financial products, and the respondent (Caixabank) was a party to many of these cases. Evidence presented to the court demonstrated that Caixabank had participated in 79 TAB arbitrations bet-

52 Manuel Conthe *Swaps de Intereses: la sentencia del TSJ de Madrid de 28 de enero de 2015,* La Ley, nº 8515, jueves 9 de abril de 2015, pgs. 1-8, conclusión.

53 The seven judgments of the Superior Court of Madrid following the Repos reasoning to annul an award in favor of BBVA in a swaps arbitration on the basis of economic public policy are: Superior Court of Justice of Madrid, April 6, 2015, judgment No. 27/2015; Superior Court of Justice of Madrid, April 14, 2015, judgment No. 31/2015; Superior Court of Justice of Madrid, May 26, 2015, judgment No. 45/2015; Superior Court of Justice of Madrid, October 23, 2015, judgment No. 74/2015; Superior Court of Justice of Madrid, November 3, 2015, judgment No. 79/2015; Superior Court of Justice of Madrid, November 17, 2015, judgment No. 85/2015; Superior Court of Justice of Madrid, January 19, 2016, judgment 3/2016.

54 Superior Court of Madrid, November 4, 2016 (appeal 79/2015).

ween 2011 and 2015 and that these cases amounted to 11.62% of TAB's revenue during this period. The Superior Court of Madrid held that arbitral institutions also have an obligation of independence and impartiality *'with the consequent reasons for abstention, and the duties of disclosure and of information that apply to the arbitrators, mutatis mutandis, are required from the institutions called to administer arbitrations.'* The Court noted that an institution needed to *'exercise extreme care in managing the arbitration where a habitual client is involved'*.[55]

The annulment application in *Construcciones Leon Rabadan S.L. v. BBVA*[56] was based on the number of repeat appointments that the members of the tribunal had had in arbitrations administered by the Court of Arbitration of Madrid ("**CAM**") involving BBVA. This award was not annulled, but the following facts appear from the judgement: there was one arbitrator (C) on this tribunal who had been appointed six times by BBVA, resulting in five awards which were favourable to BBVA, three of which had subsequently been annulled. On three occasions C had coincided in the tribunal with another member of the tribunal in this case (M), on two occasions proposed by C, and which resulted in three awards favourable to BBVA.

The appearance of repeat players is not surprising given the volume of swaps cases, and the possible demand for arbitrators to have specialist knowledge of derivatives. The AEB Framework Agreement for Financial Transactions provides in its model arbitration clause for a three-member tribunal that the arbitrators 'should have a broad knowledge of the financial products and derivatives markets.'

### G. The Restriction of the Compétence/Compétence Principle in Swaps Arbitrations:

The judicial suspicion of arbitration arising from swaps cases further manifested itself in a recent decision of the Spanish Supreme Court that increased the role of the courts in the determination of the jurisdiction of an arbitral tribunal, thereby reducing the scope of the *compétence/compétence* principle in Spanish law.

Article 11.1 of the Spanish Arbitration Act requires the courts to abstain from hearing disputes submitted to arbitration on the objection of a party, and identifies the procedure for making an objection as the plea of lack of jurisdiction (*declinatoria*). The plea of lack of jurisdiction raises the question of the extent of the court's review of the jurisdiction of the arbitral tribunal in deciding whether the court has no jurisdiction. Should the court be satisfied by prima facie evidence of the existence of a valid arbitration agreement, and leave the determination of validity and scope of the agreement to the arbitral tribunal, on the basis that the tribunal has jurisdiction over its jurisdiction? Or should the court itself rule on the validity and scope of the arbitral tribunal as part of the determination of the objection to its own jurisdiction?

55 This is not the only recent case where an award has been annulled on the basis of the conflict of interest of the arbitral institution. In *E.Life Europe S.L v Institución Ferial de Madrid (IFEMA)* 63/2013, November 13, 2014 The Superior Court of Justice of Madrid annulled an award on the basis that the institution administering the arbitration formed part of the Madrid Chamber of Commerce, which also owned 31% of the respondent in the arbitration. The court found that the indirect interest of the arbitral institution in the outcome of the arbitration violated the principle of the equality of the parties which as a matter of public policy could not be waived.

56 Superior Court of Justice, Madrid, 14 April 2016: Judgment 34/2016.





In *Banco Popular Español S.A. v Agrumexport S.A*[57]the Claimant commenced judicial proceedings seeking the nullity of a swaps contract. There was an arbitration clause in the framework agreement (CMOF) but not in the swaps confirmation. The Spanish Supreme Court, affirming lower court decisions, held that when dealing with an objection to its jurisdiction based on an arbitration agreement the Court should not confine itself to a superficial review, but should carry out a complete review of the validity, efficacy and applicability of the arbitration agreement. The effect of this decision, which reverses previous authority, is to enable a claimant to obtain a ruling on the tribunal's jurisdiction by the court before arbitration commences, thereby circumventing the *compétence/compétence* principle.

Further the interpretation of the scope of the arbitration agreement by the lower courts, limiting the jurisdiction of the arbitral tribunal to questions related to the interpretation, performance and execution of the CMOF was upheld, as it was not proved that the Claimant, in consenting to arbitration in the CMOF, had accepted clearly and unequivocally to submit to arbitration questions relating to the swaps contract.

The Supreme Court reasoned that the constitutional justification for arbitration, based on the will of the parties, requires a submission to arbitration to be 'explicit, clear, categorical and unmistakable'. This requirement has a 'special relevance' when the arbitration clause appears in an adhesion contract where one of the parties 'has chosen the arbitral solution as the most convenient to its interests'.[58] The Supreme Court distinguished previous case law requiring an expansive interpretation of an arbitration clause as applying to *"those arbitral agreements reached by negotiation, but not to those contained in contracts of adhesion since such an interpretation would not be in keeping with the justification for arbitration, which is the 'explicit, clear, categorical and unmistakable' will of the parties,* ***but of both parties****, of waiving the possibility of submitting disputes to the courts."* [59]

This Supreme Court decision significantly readjusts the balance between the courts and arbitration, demonstrates a judicial distrust in arbitration, and comes close to a rejection of an arbitration clause contained in an adhesion contract.

### H. Conclusions:

What conclusions can be drawn from the scrutiny of the arbitral process by Spanish courts in the swaps cases? I propose two sets of series of propositions.

The first set of propositions demonstrates that the information asymmetry between banks and retail investors, which is a target of the MiFID Directive, the LMV and Spanish case law, has been compounded by a procedural asymmetry in dispute resolution created by the banks' use of adhesion contracts containing arbitration clauses. To summarize:

57 Supreme Court, Civil Chamber; June 27, 2017; Judgment 409/2017.

58 *Ibid*, Fundamento de Derecho Quinto, paragraphs 2 and 3.

59 *Ibid*, Fundamento de Derecho Quinto, paragraph 6, emphasis added.

(i) The swaps cases involved a transactional relationship between banks and retail clients, where the banks were the stronger party by reason of their superior information and knowledge of the product;[60]

(ii) The stronger party directed the disputes to arbitration using adhesion contracts;

(iii) The volume of arbitrations has proved economically significant to the arbitral institutions chosen by the stronger party in their adhesion contracts;

(iv) The arbitral institutions did not voluntarily declare the extent of their economic interests in the swaps arbitrations, or the appointment history of individual arbitrators;

(v) The stronger parties have made a practice of repeat appointments of certain arbitrators.

The use of adhesion contracts containing arbitration clauses has meant that the banks entered the dispute resolution process with better knowledge of the arbitral institution (which they had chosen), of the available pool of arbitrators, and the trend of decisions. This procedural asymmetry was much greater than would exist if the disputes went into the courts, because of the confidentiality of arbitration[61], and the influence of the parties in the selection of arbitrators. This procedural asymmetry is particularly uncomfortable in securities disputes, where the legislative objective of the protection of a vulnerable party is apparently undermined by the combination of adhesion contracts and arbitration. The reputation and legitimacy of commercial arbitration might be enhanced by its exclusion from securities disputes involving retail investors, or at least by a prohibition on the combination of arbitration clauses and adhesion contracts in this type of disputes.

The second set of propositions relates directly to the outcomes of the annulment proceedings in the Spanish courts. My thesis is that different outcomes between arbitral tribunals and the courts are bad for arbitration, even where both the arbitral process and judicial scrutiny of the process are operating professionally:

(i) There has been an usually high rate of annulment in Madrid of awards arising from swaps arbitrations;

(ii) The Superior Court of Madrid has annulled numerous awards on thinly disguised merits grounds;

(iii) Both the courts and arbitrators are applying the same law to the same contracts so there should not be a significant difference in outcomes;

(iv) Different perspectives on the merits may suggest different philosophical perspectives in the courts and arbitral community: in Repos the arbitral tribunal was satisfied the applicant understood the swaps contract and was not deceived by the bank; the Superior Court of Madrid emphasized the investor protection function of the LMV; the inequality of the parties and the alleged failure of the bank to comply with its statutory assessment obligations.

60 As noted in the text above, Repos refers to 'desequilibrium, disparity or asymmetry between the parties by reason of the complexity of the product and the disparate knowledge of the contracting parties'.

61 Arbitration in Spain is confidential: see Article 24.2 of the Arbitration Act.





My ultimate conclusion, which I would generalize to international commercial and investment arbitration, is that **wherever there is a significant difference in substantive outcomes between the courts and arbitral tribunals in disputes that are identical from a legal perspective then inevitably the legitimacy of arbitration will be called into question.**

The arbitral community can respond to this conflict proactively, and make the case that the problem is in the courts; in effect that private justice operates to higher standards than public justice, at least in certain types of disputes. Indeed, at its most basic level, this is the entire rationale of the investment arbitration system.

However, investment arbitration enjoys the advantages of its own annulment system, in the case of ICSID, or at least the choice of a neutral, arbitration-friendly seat. It is also a system where there is a presumptive equality between investor and state participants. The problem in these Spanish swaps cases is precisely the inequality of the parties in the swaps relationship. **The legitimacy of arbitration requires that party autonomy, like Caesar's wife, be above suspicion, and transactional or procedural asymmetries create just such suspicions.**

An annulment mechanism is an indispensable protection in arbitration, but only operates successfully where there is mutual respect and comity between arbitrators and judges. The expansion of arbitration must not be accompanied by the suspicion that powerful interests can use arbitration as a form of haven from unwanted regulation. Judges are not always immune from irrational suspicions, and ultimately, as the Spanish Constitution mandates, citizens are entitled to the protection of their courts.