

The risk of arbitration judicialization

Madrid, February 2016

The Madrid High Court of Justice rendered a decision on 7 December 2015 setting aside an arbitration award on the ground that the award violated Spanish public policy in relation to the allocation of costs decided by the arbitral tribunal.

According to the arbitration agreement, *"the arbitration award shall decide on the party or parties that shall bear the costs of the arbitration. Unless otherwise agreed, they shall be exclusively borne by the losing party"*.

The arbitral tribunal issued an award partially upholding the claimant's claims and dismissing the respondent's counterclaim. In addition, the tribunal, taking into consideration the parties' agreement as well as section 394 of the Spanish Procedural Act, ordered the respondent to bear all the costs.

The respondent filed a motion to set aside the award arguing –among other issues– that the award violated Spanish public policy, given that the respondent had to bear all the costs of the arbitration even though the claims had only been partially upheld.

The Madrid High Court of Justice found that the decision on costs contravened Spanish public policy and set aside the award on the following grounds:

1. The Court first stated that, according to the case law on the matter –it quoted, however, case law related to State's courts litigation– any agreement on the allocation of costs shall be deemed null and void as contrary to mandatory rules set forth in the Spanish Procedural Act.
2. The Court then held that both judicial courts and arbitrators have to decide on the allocation of costs in accordance with section 394 of the Spanish Procedural Act (the *"cost follow the event"* rule), disregarding any agreement to that effect.
3. Accordingly, the Court declared that the parties' agreement as to the allocation of costs was null and void.
4. And, given that the arbitral tribunal followed such agreement and ordered the respondent to bear all the costs of the arbitration, without any justification, as required by section 394 of the Spanish Procedural Act, the Madrid High Court of Justice found that the arbitrator's ruling on costs was contrary to Spanish public policy.

In our opinion the Madrid High Court's decision is unfortunate.

Firstly, because it ignores well-established case law according to which *"no equalisation whatsoever is possible (even the slightest) between the so-called «cost of the arbitration» and the «litigation costs»"*. Secondly, it also ignores section 37.6 of the Spanish Arbitration Act, which specifically says that parties to arbitration are free to agree on the allocation of costs (*"subject to the agreement of the parties, the arbitrators shall decide in the award on the costs of the arbitration"*). Thirdly, and more worrisome, the High Court considers that the allocation of costs in arbitration is governed by the Spanish Procedural Act, when such Act is not even applicable by analogy to arbitration proceedings.

J. Almoguera y Asociados

This is not the first time the Madrid High Court of Justice holds that the Spanish Procedural Act is applicable to arbitration (see for instance, the decisions dated 5 May 2014 and 3 November 2014). However, the same Court has also rendered some decisions rightly acknowledging that "*the will of the legislature when drafting the Arbitration Act was not to follow the rules of the Procedural Act*" (more recently, in a decision dated 28 April 2015). In the same vein, the Catalonia High Court of Justice has expressly upheld that agreements on the allocation of costs are perfectly valid in arbitration and that section 394 of the Spanish Procedural Act is not –even analogically– applicable to arbitration.

This is yet another decision of the Madrid High Court of Justice inspired by a certain antiarbitration bias, as we have already commented in a previous note (see *Setting aside an arbitral award as a result of an institutional relationship between one of the parties and the arbitral institution, Madrid, January 2015*).