Again on the review of arbitral awards on grounds of public policy

Madrid, October 2016

Since the beginning of 2015, a number of (much-criticised) judgments of the Madrid High Court of Justice (**MHCJ**) have raised concerns among the Spanish arbitration community and distinguished members of the judiciary, as the MHCJ seems prone to adopt a too broad notion of public policy as a ground for setting aside arbitration awards[1].

It needs to be pointed out, however, that all of such judgments refer to domestic awards and most of them were rendered in disputes related to complex financial products in a context of a strong social pressure due to the Spanish financial crisis. It is also important to note that some of them were accompanied by well-articulated dissenting opinions by the MHCJ 's President, who warned that it is not for the judicial courts to review the merits of arbitration awards.

This approach has emerged again in a judgment handed down by the MHCJ on 14 March 2016 in relation to an ICC award rendered in the context of an international arbitration. In this case, though, the majority of the MHCJ, applying the widespread restrictive review approach, upheld the award, whereas one of the judges advocated for its vacatur.

The dispute can be summarised as follows. The French bank Dexia Crédit Local (**Dexia**) and the Spanish bank Banco Sabadell (**Sabadell**) were the sole shareholders of Dexia Sabadell (**DS**).

Dexia and Sabadell had entered into a shareholders' agreement which contained a put option in favour of Sabadell. Pursuant to said option, Sabadell had the right to sell its stake in DS to Dexia at a price to be agreed taking into consideration DS's net asset value as well as its projected cash flows.

As no agreement was possible, Dexia submitted the dispute to arbitration. Dexia alleged that, according to the criteria set forth in the shareholders' agreement, DS's value was negative, and therefore the price for the shares should be one euro. According to Sabadell, the price had to be 180 million euro.

The majority of the tribunal concluded that, pursuant to the net asset value method, the value of Sabadell's stake in DS should be 104 million euro, whereas, according to the discounted cash flow method, it would range from -18 to -37 million euro. However, the arbitration tribunal considered that a negative value could not result in a negative purchase price (because according to Spanish law the purchase price cannot be a negative figure). Therefore, the tribunal assumed that the second valuation method resulted in a price of one euro. From there, they concluded that

[1] We refer to our notes "The risk of arbitration judicialization", dated February 2016, and "Setting aside an arbitral award as a result of an institutional relationship between one of the parties and the arbitral institution", dated January 2015, that touch upon related subjects.

the strike price of the put was 52 million euro (the arithmetical mean of 104 million and 1 euro).

Dexia brought an action to set aside the award on one single ground, namely that payment of the strike price by Dexia violated EU state aid rules (Dexia had been bailed out between 2008 and 2011 by the French, Luxembourg and Belgian governments), and hence that the award was contrary to public policy. Dexia did not raise the interpretation of the shareholders' agreement carried out by the arbitration tribunal or the application of the valuation methods.

The MHCJ dismissed the action by the majority vote of two of its members. The third judge, however, issued a dissenting vote analysing the way the arbitration tribunal had determined the strike price, concluding it was arbitrary. Note that the dissenting judge raised this issue on his own motion.

According to the dissenting judge, the results of the two valuation methods (one positive and the other negative) should have been used as such. In his view, the conversion of a negative amount into a positive one (one euro) by application of a legal requirement or *fictio iuris* (the price must be a positive figure) was contrary to the letter and spirit of the shareholders' agreement, as it rendered ineffective one of the valuation methods agreed by the parties. This led the dissenting judge to claim that the award was illogically and arbitrarily reasoned, which in reality meant that the award was not a reasoned decision at all. By failing to express real reasons for the decision, the award violated the public policy.

We could well share the logical and economic analysis made by the dissenting judge about the valuation of the company and the determination of the strike price of the put, but at the same time we must highlight that the scope for judicial review of an award is limited to making sure that (i) the arbitration agreement is valid, (ii) the due process principles have been respected and (iii) the award has not gone beyond the arbitration agreement or decided on non-arbitrable matters or does not violate the public policy. Therefore, judicial courts are not allowed to second guessing arbitrator's decisions, which is precisely what the dissenting judge did. As the Andalucía High Court put it in a judgment of 11 October 2013:

> "*it is inacceptable to confuse lack of reasoning with mistaken reasoning. A bit of dialectics would always be enough in order to put forward a divergent view […]. That is why the judicial control with respect to the adequacy of the reasoning shall be limited to cases where it is impossible to ascertain the ratio decidendi, regardless its correctness*".