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# International Arbitration Report

## **Madrid Update:**

### **The Dual Power Of Spanish National Courts To Enforce And Annul Arbitration Awards When Unjust Clauses Are Rendered Void**

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# Commentary

## Madrid Update: The Dual Power Of Spanish National Courts To Enforce And Annul Arbitration Awards When Unjust Clauses Are Rendered Void

By  
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This month's article analyzes case C-40/08 handed down by the European Court of Justice (ECJ) on May 14, 2009. The Court ruled on a preliminary issue referred to it by the Bilbao Court of First Instance<sup>1</sup> (the "Court").

The question at bar is whether a national court hearing an action to enforce an award can determine on its own motion whether an arbitration agreement is void. If permitted to do so, is the same court authorized to annul such an award if it finds that the arbitration agreement contains an unfair term contrary to the consumer protections provided for in European Union Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts.

The matter giving rise to the aforesaid referral to the ECJ concerns a telecommunications company (the "Company"), which entered into a subscription contract with an individual (the "Consumer") on May 24, 2004. The contract was governed by an arbitration clause which required that any dispute arising from performance of the contract would be subject to arbitration, according to the Rules of

the Asociación Europea de Arbitraje de Derecho y Equidad (AEADE) (European Association of Arbitration in Law and Equity).<sup>2</sup>

The consumer defaulted on her agreement and terminated her subscription contract prior to the end of the minimum subscription period. The company then initiated arbitration proceedings against her before the AEADE.

The consumer did not participate in the proceedings where an award was issued requiring her to pay EUR 669.60. Neither the company nor the consumer initiated annulment proceedings to challenge the award and it became final.

An enforcement action was brought by the company before the Bilbao Court of First Instance on October 29, 2007.

The Court determined that the arbitration clause in the subscription contract was unfair for several reasons. First, the costs to travel to the seat of the arbitration exceeded the amount in dispute and it was therefore unjust to expect the consumer to pay such costs. Second, the contract did not provide alternative locations or indicate that the seat of arbitration was in Bilbao, a substantial distance from the consumer's residence. Third, the AEADE was not only the arbitration institution but was also where the company had its contracts prepared.<sup>3</sup> The Court asserted that, inter alia, these reasons contributed to

an uneven bargaining position between the consumer and the company to the detriment of the consumer due to the lack of individual negotiation of the contract terms.<sup>4</sup>

In light of this imbalance, the Court had to ensure that its application of any national law was consistent with Council Directive 93/13/ECC which protects consumers against unfair contracts.<sup>5</sup> The Court analyzed the Spanish Arbitration Act 60/2003<sup>6</sup> (the "Act") which neither mandates nor allows arbitration tribunals to examine arbitration agreements on its own motion and annul clauses which are void or unfair.<sup>7</sup>

This question is similar to that presented to the Madrid High Court and discussed in the June 2008 Madrid Update. The question was whether it was possible to examine an arbitration agreement, ex officio, pursuant to a petition for enforcement of an arbitral award if neither party had availed itself of the annulment procedure regulated by Article 40 of the Act. In the case at bar, neither the consumer nor the company took steps to annul the arbitration award.<sup>8</sup> Instead the court should focus specifically on the stage in which the award is enforced. The Court held that during this time courts are only to consider the reasons listed in article 41, section 1b., e., and f. of the Act.<sup>9</sup>

The majority position of Spanish Courts is that any allegations against the arbitral award must be consistent with the annulment procedure in Art. 40 of the Act.<sup>10</sup> Therefore if a party fails to take the necessary steps under the Act to annul the award, it shall have res judicata effect.

The Court in the case at bar also analyzed the Spanish Law 7/1998 on General Contracting Conditions<sup>11</sup> which provides that the terms of a contract are unfair when they are not negotiated by each individual in good faith.<sup>12</sup> The EU Directive 93/13/ECC states that when a contract clause is deemed unfair then it is not binding on a party.<sup>13</sup>

The EU directive which makes an unfair contract clause unenforceable against a consumer conflicted with the Law 7/1998 which asserts that beyond the reasons listed in Article 41 of the Act, an award is binding unless an annulment procedure was initiated.<sup>14</sup>

Because of the divergence between the traditional position of the Spanish courts embodied in its national laws and the EU Directive 93/13/ECC, the Bilbao Court of First Instance stayed arbitration proceedings in the case and referred the question to the ECJ.

The ECJ asserts that when there is a fundamental question of whether a national procedural provision conflicts with the application of EU law, three questions must be addressed:<sup>15</sup> (1) the role of that provision in the procedure, (2) its progress and its special features viewed as a whole, before the various national bodies, (3) the basic principles of the domestic judicial system such as the protection of the rights embodied within the defence principle of legal certainty and the proper conduct of procedure.<sup>16</sup>

The ECJ held that "*the need to comply with the principle of effectiveness in arbitration cannot be stretched so far as to mean that in circumstances such as those in the main proceedings, a national court is not only required to compensate for a procedural omission on the part of a consumer who is unaware of his rights . . . but also to make-up fully for the total inertia on the part of the consumer concerned who . . . neither participated in the arbitration proceedings nor brought an action for the annulment of the arbitration award.*"<sup>17</sup>

This statement from the ECJ is consistent with its past reasoning under Directive 93/13/ECC where it asserted that the ECJ's reasoning in such cases is "guided by the idea of consumer protection as a strategic goal."<sup>18</sup>

The case at issue today follows the ECJ line of cases which include *Oceano*,<sup>19</sup> *Cofidis*,<sup>20</sup> and *Mostaza Claro*.<sup>21</sup> Although each case presented the Court with a unique question, the ECJ held that under Article 6(1) of Directive 93/13/ECC consumers should not be bound to unfair contracts nor be continually bound by ongoing unfair terms in an agreement under article 7(1).

As previously stated, the ECJ issued a decision in response to the inquiry of the Bilbao Court of First Instance. The Court notes that the Spanish Arbitration Act prohibits an arbitral tribunal from reviewing an unfair arbitration clause on its own motion.<sup>22</sup> In addition, the Spanish Code of Civil Procedure<sup>23</sup> does not address how the court should adjudicate an action

for enforcement of a finalized arbitration award when there is an unfair clause and neither party has moved for annulment.<sup>24</sup>

On October 9, 2009 the Bilbao Court of First Instance acted in accordance with the response it received from the ECJ.

It stated that it is for the “*referring court to give due effect, in accordance with national law, to any finding in relation to the arbitration award that an arbitration clause is unfair.*”<sup>25</sup> The Court qualifies this mandate by stating that the contract is enforceable provided that no unfair clause can oblige a consumer to such unfair terms.<sup>26</sup>

In the light of the aforementioned, the Court in Bilbao determined the necessary required conditions in order to apply national laws consistent with Council Directive 93/13/ECC. A national court or tribunal hearing an action for enforcement of a final arbitration award, made in the absence of the consumer, is required when possible to assess of its own motion, whether an arbitration clause in a contract concluded between a consumer and seller is reasonable.<sup>27</sup> Therefore, it is for that court or tribunal to establish all the consequences thereby arising under national law, in order to guarantee that the consumer is not bound by that clause.

As such, this decision by the ECJ is likely to have a two-fold effect in Spain and the EU. First, there is a risk it will lessen the force of *res judicata* in final decisions and open up national courts even further to a potentially overbroad application of public policy exceptions. Second, the judgment will reinforce consumer confidence in a system which provides strong consumer protections. The latter point is one that will strengthen the system while the former is one that individuals and companies may view as weakening it.

In conclusion, although there are both positives and negatives to this ECJ ruling, the task of the Spanish national courts is ongoing. They must maintain a careful balance between consumer protection under EU law and the efficacy of judgments embodied in national law. The ECJ does make clear that when it is not possible to do both, courts are to tip the scales in favor of consumer protection.

## Endnotes

1. Juzgado de Primera Instancia No.4 de Bilbao.
2. ECJ Case C-40/08 paragraph 21.
3. Case C-40/08 paragraph 26 pg. 4.
4. *Id.*
5. Article 6(1) of Council Directive 93/13/ECC.
6. Ley de Arbitraje de 23 de diciembre de 2003.
7. Article 22(1)-(2) of the Act.
8. Hamilton, Calvin and Luis Capiel. *Mealey's International Arbitration Review*. Madrid Update: Consumer Protection — Ex Officio Declaration of Nullity of Arbitral Clauses During the Execution Phase. Vol. 23 #6 June 2008.
9. *Id.*
10. *Id.* at pg. 2.
11. Ley 7/1998, de 13 de Abril, sobre Condiciones Generales de Contratación.
12. Law 7/1998 as added to Law 26/1984 in Article 10(a).
13. Article 6(1) of Directive 93/13.
14. Hamilton, Calvin and Luis Capiel. June 2008, pg. 1.
15. Case C-312/93 Peterbroek [1995 ECR I-4599 paragraph 14 and Fallimiento Olympic-lub, para 27] and referenced in Celex No: 60830040.
16. *Id.*
17. ECJ Celex No: 60830040 pg. 6 paragraph 47.
18. *Id.* at pg. 2.
19. ECJ C-240/98 — C-244/98, paragraph 27, *Océano Grupo Editorial v. Salvat Editores*. Where the ECJ held that in order to guarantee the protection that

- Directive 93/13 intended, it can only be corrected by positive action unconnected with the actual parties to the contract.
20. ECJ C-473/00 *Cofidis*, Where the court determined it was necessary for a judge to consider, ex-officio, an unjust contract clause to protect a consumer who could not protect himself.
  21. *Mostaza Claro*, C-168/05 paragraph 36. Where the court affirmed as a mandatory provision, Article 6(1) of Directive 93/13, which states that unfair contract terms are not binding on consumers.
  22. Court of First Instance No. 4 Bilbao Madrid October 6, 2009, paragraph 26.
  23. Ley 1/2000, de 7 de Enero, de Enjuiciamiento Civil.
  24. Id.
  25. Id at paragraph 58.
  26. Id.
  27. Id. at the last unnumbered paragraph in the case. ■



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