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Landmark Swiss Decision on Failure to Comply with a Mandatory Pre-arbitral Tier

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In a decision dated 16 March 2016 (4A_628/2015), the Swiss Supreme Court decided the long-open question of the consequence of a failure to comply with a mandatory pre-tier to arbitration, finding that such failure leads to the stay of the arbitration proceedings until the pre-arbitral tier has been conducted. The modalities of the stay (in particular, the timeframe within which the arbitration proceedings shall resume in case of failure of the pre-tier) should be set by the arbitrators.

Description

X and Y entered into two contracts for the exploration, production, transport and commercialisation of oil and gas products. The contractual dispute resolution clause provided for ad hoc arbitration under the UNCITRAL Rules seated in Switzerland, preceded by conciliation under the 2001 ICC ADR Rules.

On 8 September 2014, Y filed a request for conciliation with the ICC. Subsequently, various exchanges took place attempting to schedule the meeting provided for by Article 5(1) ADR Rules, i.e. to discuss the specific ADR procedure to be followed. Article 6(1)(b) of the ADR Rules provides that the ADR proceedings shall terminate, *inter alia*, by the notification in writing to the neutral by one or more parties, at any time after the discussion referred to in Article 5(1) has occurred, of a decision no longer to pursue the ADR proceedings.

On 16 January 2015, Y filed a request for arbitration and informed the conciliator that, in view of the failure of the conciliation for reasons attributable to the respondent, it had no intention to pursue the conciliation proceedings any further. The conciliator replied that she could not close the conciliation proceedings before the discussion provided under Article 5(1) of the ADR Rules had taken place. The conciliator informed the parties and the ADR Center that she interpreted the claimant's conduct as a withdrawal of its request for conciliation. The ADR Center confirmed this interpretation.

In the arbitration, X objected that the arbitral tribunal lacked jurisdiction as the mandatory pre-arbitral conciliation tier had not been complied with. However, in an

interim award the tribunal upheld jurisdiction.

X filed a petition before the Swiss Supreme Court to set aside the award, which the Court granted. The Court emphasized that while the Article 5(1) discussion did not have to be physical, it had to satisfy the substantive content of Article 5(1). Such discussion never took place. The Supreme Court then addressed Y's argument that X had acted against good faith. It held that X had actively participated in the conciliation. When Y filed its request for arbitration, X immediately objected in the conciliation. X also immediately raised a jurisdictional objection in the arbitration. The Supreme Court further analyzed X's pre-conciliation behavior and its refusal to accede to Y's request, given with short notice in December 2014, to have party representatives participate in a call to discuss the conciliation procedure. X had in fact proposed a physical meeting of the party representatives in Paris. The Court emphasized that it was for Y to push the conciliation forward, wherefore X's alleged "passivity" was not relevant. Finally, the fact that conciliation might appear hopeless now was not decisive, because (i) X alleged that it was not, (ii) this would ratify Y's breach of the pre-arbitral tier after the fact, and (iii) in general, a third party neutral may be effective even at an advanced stage of a dispute.

This case is the first time after three previous cases since 2007 (4A_18/2007, 4A_46/2011, and 4A_124/2014) that the Swiss Supreme Court has set aside an award for failure to comply with a compulsory pre-arbitral ADR procedure. The Court decided, much in line with a majority of Swiss commentators, that a breach of mandatory pre-arbitration tier normally should only have procedural consequences.

The Court reasoned against penalizing a failure to comply with a pre-tier by means of damages, and found that to rule the claim inadmissible and terminate the proceedings would be uneconomical, forcing the parties to go through the appointment of an entirely new arbitral tribunal (with potentially serious implications on, for example, tolling of statutes of limitations). A simple stay of the arbitral proceedings was therefore far more appropriate. The Court explained that the modalities of the stay (in particular, the timeframe within which the arbitration proceedings were to resume in case of failure of the conciliation) should be set by the arbitral tribunal.

Commentary

This is an important case, designated for publication in the official Supreme Court register as a "leading case". It sets aside an arbitral award (which happens rarely in Switzerland), it furthers legal certainty by resolving a question left open since 2007, and it provides important practical guidance because contractual pre-arbitral dispute resolution mechanisms are increasingly popular.

The case holds that where a party skips without a valid excuse a mandatory contractual pre-arbitration tier – whether by failing to initiate the tier at all or by prematurely terminating the tier – the arbitral tribunal must stay the arbitration until the pre-arbitral tier has been complied with.

The Supreme Court has struggled to place this holding on solid legal footing because, as it expressly acknowledges, there is no clearly applicable basis in the Swiss *lex*

arbitri to challenge the failure to respect the pre-arbitral tier. The Supreme Court permits challenges under Article 190(2)(b) PILA, i.e. for lack of jurisdiction *ratione temporis*. By doing so, among other things, it avoids a discussion of the thorny issue of the difference between jurisdiction and admissibility in international arbitration. At the same time, the Court makes the important (albeit *obiter*) statement that by admitting a challenge under Article 190(2)(b) PILA, a violation of an pre-arbitral tier is "*certainly not sufficiently grave so as to amount to a violation of procedural public policy … but* [must] *nevertheless be sanctioned in one way or another*". Overall, it is to be welcomed that the Supreme Court, in line with its general practice, employs pragmatic reasons in this case (costs, risks of prescription), to achieve a satisfactory result on what some may consider a somewhat unsatisfactory doctrinal basis.

This decision completes the Supreme Court's sound line of case law from 2007, 2011, and 2014 regarding multi-tiered dispute resolution clauses. It strikes a healthy balance between holding the parties to their bargain of seeking to resolve their dispute through other means of ADR prior to resorting to arbitration, whilst at the same time ensuring that the non-compliance of such pre-tiers cannot be used (or abused) to derail an arbitral process that has already been initiated. Parties and arbitrators confronting multi-tiered dispute resolution clauses now have clarity that

- The first step is to decide whether the pre-arbitral tier is indeed mandatory.
- If it is mandatory, the question is whether the party seeking to rely on the non-compliance of the pre-tier has indeed acted in good faith. If not, such party cannot rely on the non-compliance of the pre-tier, even if mandatory.
- Finally, if a pre-tier is mandatory and the party seeking to enforce such tier acted in good faith, the tribunal must stay the arbitral proceedings until the pre-arbitral tier has been complied with, and should in its order to stay set the framework, including in particular the timeframe, for the conduct of the pre-arbitral tier.

This case is also notable because it enforces compulsory pre-arbitral ADR clauses not only where the pre-arbitral process was not initiated at all but also where the process was set in motion but was ended prematurely. This is potentially problematic because it opens the door to debate on *why* the process is said to have ended "prematurely". Where there is an objectively recognizable milestone that the ADR process must achieve, the determination whether the ADR process was terminated "prematurely" is not overly difficult. However, problems may arise where it is argued that the pre-arbitral process was terminated "prematurely", or more generally not complied with, due to a party's alleged failure to engage in "good faith". To argue this question, it would be necessary to plead to the Court what occurred in the ADR process. Moreover, under the procedural rules relating to setting-aside proceedings, the parties' pleadings before the Court are provided to the arbitral tribunal for comment. This has the obviously undesirable consequence of making the arbitral tribunal privy to the positions that the parties took in the pre-arbitral conciliation or mediation process, with the risk of compromising the pre-arbitral ADR process. In practice, these problems may not arise where the arbitral tribunal makes a finding of fact that a party did engage in the process in good faith, because the Court is bound by the arbitral tribunal's findings of fact. However, "good faith" is arguably a legal, not a factual concept. It remains to be seen how the Court will tackle these questions when they arise. In any event it is very unlikely that the Court would be prone to second-guessing

arbitral tribunals on an issue such as this.

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