The Swiss Federal Court Confirms an Award Granting Damages for the Violation of an Arbitration Clause

Kluwer Arbitration Blog
July 7, 2010

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Please refer to this post as: Georg von Segesser, 'The Swiss Federal Court Confirms an Award Granting Damages for the Violation of an Arbitration Clause', Kluwer Arbitration Blog, July 7 2010, http://arbitrationblog.kluwerarbitration.com/2010/07/07/the-swiss-federal-court-confirms-an-award-granting-damages-for-the-violation-of-an-arbitration-clause/

In a decision dated 11 February 2010, published on 29 March 2010 (case 4A_444/2009), the Swiss Federal Supreme Court dismissed an appeal against a tribunal's decision that it had jurisdiction over a request for declaration that damages are owed due to the violation of an arbitration clause. The Supreme Court dismissed the appeal because it had not been filed in a timely manner. However, it also held that the tribunal's declaratory judgment concerning damages for breach of an arbitration clause did not violate Swiss public policy.

Background

On 1/22 December 2004, a Swiss manufacturer of pharmaceutical products ("Manufacturer") and an Israeli distributor of such products ("Distributor") entered into an exclusive distributorship agreement ("Agreement") containing an arbitration clause. On 30 Mai 2006, after having terminated the Agreement, the Manufacturer initiated arbitration proceedings in Switzerland against the Distributor requesting payment of unpaid bills and of penalties. On 20 September 2006, the Distributor filed a claim against the Manufacturer before the district

court in Tel Aviv-Jaffa requesting payment based on its claim for goodwill.

Before the district court in Tel Aviv-Jaffa, the Manufacturer requested that the proceedings be suspended due to the pending arbitration concerning identical parties and claims. Before the arbitral tribunal, on 21 June 2007, the Manufacturer requested, among others, a payment of CHF 100'000 arguing that the Distributor, by filing a claim before the district court in Tel Aviv-Jaffa, violated the arbitration clause. As to the violation of the arbitration clause, the Manufacturer later amended its prayer for relief and requested that the arbitral tribunal declare that the Distributor, due to this violation of the arbitration clause, owed the Manufacturer a compensation for damages suffered (Manufacturer's request no. 4). The Distributor requested, among others, that the tribunal deny its jurisdiction with respect to the Manufacturer's request no. 4.

On 19 November 2008, in a Partial and Interim Award, the arbitral tribunal declared that it had jurisdiction with respect to Manufacturer's request no. 4. No appeal was filed against this decision. On 3 August 2009, in a Second Partial and Interim Award, the arbitral tribunal, among others, confirmed its jurisdiction with respect to Manufacturer's request no. 4. It further held that the Distributor had "breached the Arbitration Clause" contained in the Agreement "by filing its claim for goodwill in Israel on 20 September 2006" and that the Distributor is liable to the Manufacturer for damages "incurred as a result of this breach", provided that the Manufacturer, in later arbitral proceedings, can establish the remaining elements of its claim under Article 97 of the Swiss Code of Obligations.

The Distributor appealed against the decision of the arbitral tribunal before the Swiss Federal Supreme Court.

Decision

Before the Federal Supreme Court, the Distributor argued several reasons for setting aside the decision of the arbitral tribunal. As to the Manufacturer's request no. 4, the Distributor argued before the Supreme Court that (i) the arbitral tribunal did not have jurisdiction and that (ii) it violated Swiss public policy as it dealt with the request for declaratory judgment although the Manufacturer did not show that it had legally relevant interest in such declaratory judgment and, (iii) as it denied the Distributor's right to address a constitutionally guaranteed state court with its claim.

As to the jurisdiction of the arbitral tribunal regarding the Manufacturer's request no. 4, the Federal Supreme Court held that the arbitral tribunal's decision of 19 November 2008, where the arbitral tribunal declared that it had jurisdiction with respect to Manufacturer's request no. 4, had not been appealed. The Distributor had filed an appeal only against the tribunal's decision of 3 August 2009, however in this latter decision the tribunal only confirmed its respective decision of 19 November 2008 without deciding the issue of jurisdiction anew. The Distributor should have – but has not – appealed against the decision of 19 November 2008 in order to dispute the tribunal's jurisdiction regarding the Manufacturer's request no. 4. The Federal Supreme Court further held that the Distributor should have shown that the issue of violation of the arbitration clause is not covered by the arbitration clause itself and therefore the tribunal did not have jurisdiction to decide that issue. Instead, according to the Federal Supreme Court, the Distributor mixed the issue of the violation of the arbitration clause and of the jurisdiction over the Distributor's goodwill claim.

The Distributor's further argument that an arbitral tribunal may not influence the state court's decision on costs of the proceedings and, in particular, may not punish a party for addressing a state court with its claims, also failed as the tribunal had only decided on its own jurisdiction (and not the jurisdiction of the state court) and did not try to influence the state court's decision on costs. The Federal Supreme Court held that awarding the counterparty damages for the violation of the arbitration clause is a decision in substance and has nothing to do with the issue of jurisdiction. It could thus not be brought before the Federal Supreme Court.

As to the Distributor's argument that the tribunal violated Swiss public policy in deciding over the request no. 4, the Federal Supreme Court held that the Distributor was right in alleging that, where Swiss law is applicable, according to the rules developed by Swiss state courts, the admissibility of a request for declaratory relief must be determined in accordance with Swiss law. However, since neither the requirements of Swiss law that need to be met for a request for a declaratory relief to be admissible before Swiss state courts nor the question of which requirements must be applied by an international arbitral tribunal constitute Swiss public policy, the Supreme Court denied to deal with Distributor's argument that the arbitral tribunal did not properly apply said requirements.

The Distributor also argued that the tribunal violated Swiss public policy because it

denied the Distributor's right to address a constitutionally guaranteed state court with its claim. Here, the Federal Supreme Court held that with respect to arbitrable claims the parties are free to exclude the state court jurisdiction by entering into an arbitration clause. Since the Distributor and the Manufacturer validly concluded the arbitration clause, the exclusion of the state court jurisdiction was binding and the tribunal did not violate the public policy by deciding Manufacturer's request no. 4.

Comment

With respect to the issue of jurisdiction, this decision clearly shows the importance of a timely complaint against an interlocutory award. Article 190 para. 3 of the Swiss Private International Law Act ("PILA"), which states that the time limit for lodging an appeal shall commence when the interlocutory award is communicated, does not only constitute a party's right but also a party's duty to appeal in a timely manner.

A further interesting issue in this case is the issue of claims for damages based on the fact that one party has, in breach of the arbitration agreement, filed a claim in another court. Although the Federal Supreme Court did not have to address this issue because of late filing of the appeal, it stated obiter dictum that an arbitral tribunal has jurisdiction for such claims. Furthermore, regarding the merits of the damage claim, it rejected the ordre public violation claim which was based mainly on the fact that the Israeli courts had accepted their jurisdiction and thus no violation of the arbitration clause could be perceived. This decision might deter parties in arbitration proceedings with seat in Switzerland to file parallel proceedings before state courts.

As to the question of which rules apply to the admissibility of declaratory relief in international arbitration (since such issue does not pertain to the public policy), the Federal Supreme Court left such question unanswered. The following comments, however, are noteworthy:

In the Swiss legal literature it is disputed whether the test for admissibility of declaratory relief pertains to the procedure or to the substance (merits) of the case. If this question is considered a procedural issue, there is some uncertainty for the users of arbitration what test (if any) applies (since the procedural rules at the seat of the arbitral tribunal do not apply automatically). If it is considered a

substantive issue, under Swiss law the situation is as follows: Prayers for declaratory relief are limited to seeking a declaration on the existence or non-existence of a certain legal relationship or on the legal consequences of such legal relationship based on certain facts. Where a party is in a position to request specific performance of duties arising from the same legal relationship or payment of a certain amount of money, a request for declaratory relief is inadmissible and must be dismissed without prejudice. More specifically, where a request for specific performance is possible, the party seeking merely a declaratory relief lacks the “legally relevant interest” in such declaratory relief because the uncertainty pertaining to the legal relationship between the parties can be eliminated by way of the performance request and therefore such performance request is a valid option for obtaining an enforceable judgment granting an affirmative relief. Only where the request for performance is not possible and the uncertainty regarding the legal relationship between the parties can only be eliminated by way of a declaratory judgment, an interest in a declaratory judgment is worthy of protection under Swiss law.

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