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Multi-tier Dispute Resolution Clauses: Swiss Supreme Court Considers Impact Of (Omitted) Pre-arbitral Expert Appointment and Conciliation on Arbitral Tribunal's Jurisdiction

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In a recent decision, the Swiss Supreme Court examined whether contractual provisions contemplating certain procedural steps before initiating arbitration proceedings impacted the jurisdiction of the arbitral tribunal (Case no. 4A_46/2011 of 16 May 2011, to be published in ASA Bulletin, 2011. English translation to be published in Swiss International Arbitration Law Reports, 2011). The contract, governed by Swiss substantive law, concerned the delivery and installation of an industrial production line from a German supplier to an Algerian buyer (“Contract”).

Art. 18(3) of the Contract provided: “In case of a dispute concerning the conformity or non conformity of the supplies and services, the buyer and the supplier must appoint a neutral expert before submitting the dispute to an arbitral tribunal” (Original: “En cas de contestations concernant la conformité ou la non-conformité des fournitures et prestations, l’acheteur et le fournisseur doivent avoir recours à un expert neutre avant de soumettre le litige à un tribunal arbitral”).

Art. 20 of the Contract provided: “(1) in the event of a dispute concerning the interpretation or performance of the contract, the parties will first seek to find an amicable settlement. (2) The possible disputes arising from the interpretation or performance of the provisions of the contract will be submitted, after the failure of the conciliation attempt, to an arbitral tribunal, without any recourse to the state courts. The arbitral tribunal will consist of three arbitrators. Each party shall designate an arbitrator”. (Original : « (1) En cas de litige à l’occasion de l’interprétation ou de l’exécution des présents, un accord à l’amiable sera d’abord recherché par les parties. (2) Les litiges éventuels qui viendraient à naître du fait de l’interprétation ou de l’exécution des dispositions du présent MARCHÉ seront soumis, après échec d’une tentative de conciliation, à un tribunal arbitral, sans aucun recours aux tribunaux judiciaires. Le tribunal arbitral sera composé de 3 arbitres. Chacune des parties désigne un arbitre. »)

In 2009, the buyer initiated arbitration, claiming some € 5 million for alleged defects in the production line. The supplier objected to the arbitration. In its view, as no expert had been appointed and as there was no attempt to settle the dispute through conciliation, the buyer had failed to abide by the pre-arbitral procedures set out in Arts. 18 and 20 of the Contract. Consequently, the arbitration was inadmissible (“irrecevable”). Alternatively, the supplier contended that the arbitration was premature until the pre-arbitral procedures were completed and

until the buyer paid the supplier a sum of € 1 million as compensation for having failed to perform the pre-arbitral procedures. At a hearing in January 2010, the arbitral tribunal rejected the supplier's jurisdictional objections. The reasoning for the decision was contained in the final award.

In the final award (rendered in December 2010), the tribunal partially upheld the buyer's claims and ordered the supplier to pay certain amounts to the buyer. Additionally, the tribunal explained the reasons why it held that the buyer had not, by failing to satisfy the pre-arbitral requirements, breached Arts. 18 and 20 of the Contract.

First, according to the tribunal, the expert to be appointed under Art. 18(3) of the Contract would determine the technical aspects of the specific defects in the production line. Thus, a technical task would be performed by the expert. On the other hand, the dispute before the tribunal was primarily legal. Second, the main role of the expert was to assist the parties in finding an acceptable solution. Given that the dispute was completely outside his mission, it was doubtful that the expert would achieve this goal. Third, in light of the parties' opposing positions, it was unlikely that the expert (looking solely at technical issues), could have persuaded them to reach an agreement. The tribunal held that the supplier had failed to demonstrate that appointment of the expert could have allowed the parties to settle the dispute before the arbitration. Consequently, the tribunal rejected the supplier's argument that the arbitration was inadmissible. It also rejected the alternative argument that the arbitration should be stayed until the expert had issued his technical report.

Regarding Art. 20, the tribunal found that the provision was not sufficiently clear to support the argument that absence of an attempt at conciliation would lead to inadmissibility of the arbitration. In fact, a meeting between the parties had taken place. According to the tribunal, it was not important that the meeting was informal. The parties had not settled their dispute, which showed the deterioration of their relationship. Consequently, as a last resort, arbitration was the only solution. Given the irreconcilable positions taken by the parties, the tribunal held that it would be 'excessively formalist' to declare the request for arbitration inadmissible (or to grant the application for stay) on grounds of alleged violation of Art. 20.

The supplier applied to the Swiss Federal Supreme Court (having exclusive jurisdiction to decide all applications against all international arbitration awards rendered in Switzerland) to set aside the final award. The supplier, *inter alia*, took the view that the arbitral tribunal lacked jurisdiction (Art. 190(2)(b) PIL Act). The supplier argued that the appointment of an expert and the holding of a conciliation meeting were mandatory pre-requisites for arbitral proceedings. In its opinion, the arbitral tribunal had erred in assuming jurisdiction despite the alleged violation of these requirements. In a preceding case, 4A_18/2007, the Supreme Court had ruled that arbitration may be premature if there is a failure to comply with pre-arbitral procedures. In such cases, the temporal scope of application of the arbitration clause was at stake.

In the instant case, the Supreme Court confirmed that a party believing that a mandatory pre-arbitral procedure had not been followed, could rely on Art. 190(2)(b) PIL Act (lack of jurisdiction). However, it was unclear what sanctions would apply in such a case. Sanctions could include: (i) temporary inadmissibility of the request for arbitration, (ii) dismissal of the claim, (iii) compensation for damages, or (iv) any combination of the above. The Court found that this was a controversial issue. However, it expressly rejected the supplier's proposition that there was a clear tendency that requests for arbitration are to be declared inadmissible for being premature. It observed that most scholars (at least in Switzerland), advocated temporary suspension of the

arbitration and setting a time limit for the parties to perform the omitted procedures. The Court held that no uniform rule could be laid down for all cases where a party failed to abide by a compulsory pre-arbitral dispute settlement procedure. Ultimately, since the supplier's position was not supported by facts, the Court found that it did not have to make a ruling on this controversial issue.

The Supreme Court is bound by the factual findings of the arbitral tribunal. The latter had found that the questions before it were not the same as those before the expert under Art. 18. Further, the Court considered that the arbitral tribunal's conclusion that the appointment of an expert would not have resulted in a settlement, was not speculative (given the parties' irreconcilable positions). Consequently, the Court rejected the supplier's argument that the Contract provided for compulsory appointment of an expert.

The Court found no violation of the alleged obligation to hold a conciliation meeting. It interpreted the dispute resolution clause in accordance with the general rules of contract interpretation. The Court found that Art. 20(2) lacked the specificity required for a compulsory conciliation clause. The clause did not prescribe a time limit for initiation of conciliation proceedings. Neither did it specify whether a mediator should be appointed. Further, it did not provide any procedural framework for the conciliation. On the other hand, the language of Art. 20(1) ("in the event of a dispute concerning the interpretation or performance of the contract, the parties will first seek to find an amicable settlement"), supported the supplier's view that Art. 20(1) was intended to be compulsory. This begged the question whether "amicable settlement" (Art. 20(1)) was the same as "conciliation" (Art. 20(2)). As the supplier's arguments were not supported by facts, the Court did not answer this question. In fact, the Court espoused the arbitral tribunal's view that the fact that the parties had held discussions (even informally), showed that there had been an attempt to conciliate. Breakdown of discussions showed how far apart the parties were. Consequently, the Court held that the supplier's arguments, blaming the buyer for having failed to find an amicable solution, were not made in good faith.

Nevertheless, the supplier was successful in having the award set aside. The Supreme Court found that the tribunal had violated the supplier's right to be heard...but that will be food for another blog.

What conclusions may be drawn from the decision?

- i. Based on the Swiss Federal Supreme Court's express statement, it is clear that there is no general rule as to the sanctions applicable in the event of a party's failure to perform pre-arbitral procedures. Inadmissibility of arbitration is clearly not favored by the Court. Rather, the Court seems to prefer granting damages and/or temporarily staying the arbitration, allowing parties to perform the pre-arbitral procedures. In the instant case, as the supplier (plaintiff) failed to show a violation of the pre-arbitral procedures, the question was left unanswered.
- ii. Violation of pre-arbitral procedures is a ground for challenging an international arbitration awards rendered in Switzerland (Art. 190(2)(b) PIL Act).
- iii. The plaintiff would have to show that the (temporal or general) validity of the arbitration clause depends on proper implementation of a compulsory pre-arbitral procedure, which was not implemented.
- iv. The more specific and binding the contractual language used to describe the pre-arbitral mechanism, the more likely arbitral tribunal's and the Court will sanction the absence of its implementation, and vice versa.

v. Although not clearly stated, parties must undertake the required steps antecedent to arbitration in good faith. However, bad faith cannot be presumed merely if a party insists on its position.

Cases where a pre-arbitral procedure is not followed must be distinguished from those where the procedure is followed, but the arbitration agreement expires due to the lapse of time. For instance, in *Vekoma v. Maran* (reported in ASA Bulletin 1996, 673), the Supreme Court considered an arbitration clause providing that arbitration had to be initiated within 30 days “after it was agreed that the difference or dispute cannot be resolved by negotiation.” The ICC arbitral tribunal construed this clause as imposing a time limit on the validity of the arbitration agreement i.e. after 30 days had lapsed, the arbitration agreement would become void. The arbitral tribunal found that the 30 day time limit had been observed, and rendered an award. The Supreme Court disagreed. In its view the validity period had lapsed. The Court set aside the award.


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This entry was posted on Wednesday, May 25th, 2011 at 10:50 am and is filed under [Arbitration](#), [Jurisdiction of the arbitral tribunal](#), [Pre-arbitral procedure](#), [Set aside an arbitral award](#), [Supreme Court](#),

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