Consequences of a failure to comply with compulsory pre-arbitral steps. Note on the Swiss Supreme Court’s Decision 4A_628/2015 of 16 March 2016 (ATF 142 III 246)

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Consequences Of A Failure To Comply With Compulsory Pre-Arbitral Steps

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I – JULGADO

4A_628/2015¹

Judgment of March 16, 2016
First Civil Law Court

Federal Judge Kiss (Mrs.), Presiding
Federal Judge Klett (Mrs.)
Federal Judge Kolly
Federal Judge Hohl (Mrs.)
Federal Judge Niquille (Mrs.)
Clerk of the Court: Mr. Carruzzo

X.________ Ltd.,
Represented by Mrs. Dominique Ritter and Mrs. Diane Grisel,
Appellant

v.

Y.________ S.p.A., Represented by Mr. Elliott Geisinger, Mrs. Anne-Carole Cremades and Mrs. Julie Raneda,
Respondent

I – COMENTÁRIO

I – INTRODUCTION

In a landmark decision of 16 March 2016, the Swiss Supreme Court had to determine the consequences of a failure of a party to comply with a compulsory pre-arbitral step. The Court held that the most appropriate solution was to annul

¹ See: http://www.swissarbitrationdecisions.com/sites/default/files/16%20mars%202016%204A%20628%202015.pdf.
the arbitral tribunal’s award on jurisdiction and to stay the arbitral proceedings until such time as the relevant pre-arbitral step has been implemented.

II – BACKGROUND

In 2001, X Ltd and Y S.p.A. entered into a series of agreements for the exploration, production, transport, transformation and commercialisation of oil and gas products. The agreements all contained the same dispute resolution clause which provided as follows:

“Tout différend survenant entre les Parties dans l’exécution ou dans l’interprétation du présent Contrat qui ne peut être résolu par les Parties, fera dans un premier temps, l’objet d’une tentative de conciliation en application du Règlement ADR (Alternative Disputes Resolution) de la Chambre de Commerce Internationale (CCI).

“Tout différend entre les Parties découlant de l’exécution ou de l’interprétation du présent Contrat non résolu par voie de conciliation sera tranché en dernier ressort par voie d’arbitrage conformément au Règlement d’Arbitrage de la CNUDCI (UNCITRAL) par trois (3) arbitres nommés conformément à ce règlement.

“Le lieu de l’arbitrage sera Genève, Suisse.”

Article 5 (1) of the ICC ADR Rules (2001) provides as follows:

“The Neutral and the parties shall promptly discuss, and seek to reach agreement upon, the settlement technique to be used, and shall discuss the specific ADR procedure to be followed.”

On 8 September 2014, Y filed a request for conciliation in accordance with the ICC ADR Rules.

On 16 November 2014, the ICC appointed the Neutral, pursuant to Article 3 ICC ADR Rules.

On 14 November 2014, the Neutral submitted to the parties a series of questions on the conduct of the conciliation proceedings and proposed to convene a meeting.

On 20 November 2014, Y replied to the Neutral’s questions and requested that the meeting take the form of a telephone conference. On even date, X

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2 In English: “Any dispute arising between the Parties in the execution or interpretation of the present Contract that cannot be resolved by the Parties, shall, as a first step, be the object of an attempt of conciliation under the ADR (Alternative Disputes Resolution) Rules of the International Chamber of Commerce (ICC).

“Any dispute between the Parties arising from the execution or interpretation of the present Contract not resolved by way of conciliation shall be settled as a last resort by way of arbitration according to the UNCITRAL Arbitration Rules by three (3) arbitrators nominated in accordance with these Rules.

“The place of arbitration shall be Geneva, Switzerland.”
answered the Neutral’s question and indicated the dates on which it would be available for a conference.

On 16 December 2014, the Neutral set the conference call for the following day at 15:30h. The next day, on 15:20h, Y’s counsel sent an email to the Neutral and X’s counsel announcing the participation of his client’s representatives and offering to use his conference call dial-in. X’s counsel objected on the ground that the conference call had been planned between the Neutral and counsel only and that he had not made any arrangement for the participation of his own client’s representatives. Therefore, he suggested that the conference call shall either be held as originally planned (with counsel only), or that the meeting be postponed to a later date, in which case the meeting should be held physically in Paris in view of the tentative number of participants. Y’s counsel replied that it had never been decided that the telephone conference would be held with counsel only, but agreed to the postponement of the meeting.

On 8 January 2015, the Neutral inquired with the parties on how to proceed with the conciliation.

On 16 January 2015, Y filed a notice of arbitration against X in accordance with the UNCITRAL Arbitration Rules and designated its arbitrator. On the same day, Y informed the Neutral that it considered the conciliation as having failed due to X, and that it had no intention to pursue the conciliation.

On 20 January 2015, X informed the Neutral that there was no basis to order the termination of the conciliation proceedings which had not even commenced due to reasons not attributable to it.

On 21 January 2015, theNeutral informed the parties that she could not terminate the conciliation proceedings without the discussion provided under Article 5(1) ICC ADR Rules having taken place, and thus suggested new dates for a meeting with counsel and representatives of both parties.

In an email of 26 January 2015, Y maintained that the conciliation proceedings had terminated. Thereupon, the Neutral informed the parties, on 30 January 2015, that she interpreted Y’s behaviour as a withdrawal of the case, and informed the ICC accordingly.

On 3 February 2015, the ICC informed the parties that it also considered Y to have withdrawn its request for conciliation. After a further exchange of submissions, the ICC, on 8 April 2015, confirmed the termination of the conciliation proceedings stating that Y had failed to pay its share of the advance payment, pursuant to Article 6 (1) (f) ICC ADR Rules.

Meanwhile, Y pursued the arbitration initiated under the UNCITRAL Arbitration Rules. For its part, X informed Y by letter of 26 January 2015 that the
notice of arbitration was inadmissible, as the conciliation proceedings were still pending. In a further letter of 19 February 2015, X informed Y of its intention to contest the arbitral tribunal’s jurisdiction in accordance with the applicable Swiss arbitration law, and designated its arbitrator. During the next months, the parties discussed the modalities for the designation of the president of the arbitral tribunal, while X persistently reserved its right to raise the plea of lack of jurisdiction. On 22 May 2015, the secretary general of the Permanent Court of Arbitration nominated the president of the tribunal.

On 31 July 2015, the arbitral tribunal decided that, as a first step, it shall decide on its jurisdiction. After two exchanges of written submissions, the arbitral tribunal rendered an award on jurisdiction dated 13 October 2015 whereby it rejected X’s plea of lack of jurisdiction and declared that Y’s claim was admissible.

On 16 November 2015, X filed an action for annulment with the Swiss Supreme Court, requesting the latter to set aside the award on jurisdiction and to declare that the arbitral tribunal lacks jurisdiction *ratione temporis*. X argued that the arbitral tribunal had misinterpreted the compulsory pre-arbitral conciliation mechanism, and maintained that the discussion with the Neutral as prescribed by Article 5 (1) ICC ADR Rules had not taken place, as confirmed by the latter and the ICC, with the result that the arbitral tribunal should have declined its jurisdiction *ratione temporis* or, at least, stayed the arbitral proceedings to allow for a meeting between the parties and the Neutral.

For its part, Y requested the Supreme Court to dismiss the challenge, arguing that X’s reliance on the pre-arbitral ADR mechanism constituted an abuse of rights, that the dispute resolution clause merely required an attempt of conciliation, but not necessarily one that had to comply strictly to the ICC ADR Rules, and that the arbitral tribunal was not bound by the statements of the Neutral and the ICC concerning the termination of the conciliation proceedings.

By judgment of 16 March 2016, the Swiss Supreme Court has admitted the challenge, annulled the award on jurisdiction and ordered the suspension of the arbitral proceedings pending the completion of the (compulsory) pre-arbitral conciliation proceedings in accordance with the ICC ADR Rules.

**III – SUMMARY OF THE SUPREME COURT’S DECISION**

The Supreme Court first recalled that the failure to comply with a compulsory pre-arbitral ADR procedure can be challenged with an action for annulment on the grounds of lack of jurisdiction, pursuant to Article 190 (2) (b) of the Swiss Private International Law Act (PILA). More specifically, the Supreme
Court considers such failure to fall within the scope of lack of jurisdiction *ratione temporis* (see also 4A_124/2014 of 7 July 2014; 4A_46/2011 of 16 May 2011; 4A_18/2007 of 6 June 2007). The Court further recalled that in the context of a challenge based on Article 190 (2) (b) PILA, it examines the legal questions that determine the jurisdiction of the arbitral tribunal with unfettered powers of review.

Thereafter, the Supreme Court set out the relevant test to be applied when seized with the question of whether or not a compulsory pre-arbitral ADR procedure has been complied with. According to the Supreme Court, the first step is to determine the relevant ADR procedure chosen by the parties. As a next step, it must be examined whether the relevant ADR method has been complied with. If not, it must be verified that the party invoking the plea of lack of jurisdiction was entitled to do so without committing an abuse of rights. If so, the last issue to be determined is the appropriate sanction for the failure to comply with the relevant pre-arbitral ADR procedure.

1 The relevant ADR procedure

Under the first prong of the test, the Supreme Court examined the scope of the pre-arbitral ADR mechanism agreed by the parties. In the present case, this was a matter governed by Swiss law as the law applicable to the dispute resolution clause in the various agreements, pursuant to Article 178 (2) PILA.

In so doing, relying on the clear wording of the clause, the Court determined that the parties must have intended that recourse to arbitration shall be conditional upon the conduct of conciliation proceedings in compliance with the ICC ADR Rules. It therefore rejected Y’s position that the contractual dispute resolution clause merely provided for an “attempt of conciliation” without regard to the procedure provided for in the ADR Rules.

2 Compliance with the agreed ADR procedure

Under the second prong of the test, the Supreme Court examined whether the agreed pre-arbitral ADR procedure had been properly applied. In this regard, the Court determined that Article 5 (1) ICC ADR Rules prescribes that a meeting before the Neutral to discuss the settlement technique to be used and the specific ADR procedure to be followed must take place before either party can unilaterally terminate the conciliation. In the present case, the Court noted that no such discussion had taken place, neither at a meeting or telephone conference, nor in the course of the various exchanges of letters and emails.
3 Abuse of rights

Under the third prong of the test, the Supreme Court proceed to the examination of X’s argument of bad faith. In previous cases, the Supreme Court had considered a plea of lack of jurisdiction *ratione temporis* to be contrary to the principle of good faith if the party invoking the plea had not, on its own initiative, offered to proceed to conciliation or mediation before its opponent initiated the arbitration (see 4A_18/2007 of 6 June 2007 E.4.3.3.1; 4P.67/2003 of 8 July 2003 E.4). In the present case, however, the Supreme Court considered that the circumstances were different. X had participated in the conciliation. X had promptly objected in the conciliation when Y filed its notice of arbitration. Likewise, it had promptly raised and maintained the issue of jurisdiction in the arbitration. The Supreme Court therefore considered that it would have been for Y to continue with the conciliation. Also, it rejected the argument that a new conciliation, in the circumstances of the case, would have no likelihood of success. As a result, the Court found that X’s reliance on the compulsory pre-arbitral ADR mechanism constituted no abuse of rights.

4 Determining the appropriate sanction

Finally, the Supreme Court had to determine the appropriate consequence of a failure to comply with a compulsory pre-arbitral ADR procedure, after this controversial question had been left open in previous cases (see 4A_18/2007 of 6 June 2007 E.4.3.2.; 4A_46/2011 of 16 May 2011 E.3.4). Having regard to legal writing on point, the Court noted that there were in principle three alternative solutions to be discussed and weighed against each other.

According to the first option, an arbitral tribunal that has been seized in breach of a compulsory pre-arbitral ADR mechanism may simply proceed with the arbitration in spite of the failure; the party in breach merely runs the risk of having to pay for potential damages resulting from the breach.

In the result, this first option would have meant for the Supreme Court to simply dismiss the action for annulment. The Court, however, rejected this solution with the convincing argument that in most cases it will be difficult, if not impossible, for the aggrieved party to substantiate such damages, such that in most cases there will not be any meaningful remedy against the breach of a compulsory pre-arbitral ADR mechanism.

Under the second alternative, an arbitral tribunal that has been seized in breach of a compulsory pre-arbitral ADR procedure must dismiss the case outright for lack of jurisdiction or inadmissibility, entailing the termination of the arbitration.
This second option would have meant for the Supreme Court to admit the action for annulment and declare that the arbitral tribunal lacks jurisdiction to hear the case. Again, the Court rejected this possibility with the persuasive argument that this would render the arbitral tribunal *functus officio*, thus forcing the parties to go through the costly and time-consuming process of appointing a new tribunal once the dispute could not be settled through the (compulsory) ADR procedure, alongside with potentially adverse effects for the claims at issue, such as the risk of expiry of limitation periods.

According to the third option, an arbitral tribunal that has been seized in breach of a compulsory pre-arbitral ADR mechanism shall stay the arbitration until such time as the parties have implemented or completed the pre-arbitral step.

Having decided against the other two options, the Supreme Court concluded that this third alternative was to be preferred as being the solution which to the best extent possible balanced the (conflicting) interests of the parties. Accordingly, it decided to admit the action for annulment, annul the award and order the suspension of the arbitration pending the completion of the (compulsory) pre-arbitral ADR proceedings. The Court added that the modalities of the stay should be left for determination by the arbitral tribunal.

IV – COMMENTS

The Court emphasised that its choice for the third option may not necessarily be the appropriate answer to all future cases ("...on peut raisonnablement douter que la question controversée puisse recevoir une réponse adaptée à tous les cas de figure envisageables").

Despite this reservation, it is suggested here that this judgment of the Court has settled the controversy for most future cases by expressing a strong and well-reasoned preference in favour of one solution, namely the temporary suspension of the arbitration. As such, the decision provides helpful guidance for the users of Switzerland as a place for international arbitration, considering that multi-tier dispute resolution clauses are on the rise and in certain industries even commonplace. In case of a failure to comply with a compulsory pre-arbitral step, the suspension of the arbitration will indeed in most cases be the appropriate way to “sanction” the relevant breach of contract, it being understood that the aggrieved party’s insistence on a stay must comply with the principle of good faith.

For the claimant in the arbitration, the decision stresses that – to the extent compulsory – a pre-arbitral ADR procedure must in principle be complied with, whilst leaving room for initiating arbitral proceedings prematurely if necessary.
(e.g. for complying with limitation periods). For the respondent, on the other hand, the decision also makes clear that it cannot arbitrarily invoke the breach of a pre-arbitral ADR procedure under any circumstances, as a means to disrupt the already (prematurely) commenced arbitral proceedings.

To sum up, the decision provides practical guidance for parties and arbitrators when having to deal with multi-tier dispute resolution clauses in which the final tier provides for arbitration in Switzerland. As a first step, it must be assessed whether the pre-arbitral ADR procedure is compulsory. If so, the claimant may still decide to skip the step and initiate arbitral proceedings. If the claimant so proceeds, this allows the respondent to request for a suspension of the arbitration, always provided however, that its insistence on the compliance with the pre-arbitral ADR procedure is not raised in bad faith.

Admittedly, from the perspective of the claimant, a suspension of the arbitration may be a burdensome consequence, both in terms of time and costs. But it appears to be the most adequate “price” to be paid by it for having agreed on a compulsory pre-arbitral ADR procedure. The parties can always avoid the risk of a stay altogether and in advance, by expressly stating in their multi-tier dispute resolution clause that any of the pre-arbitral steps is not compulsory. The latter is indeed what the parties should seriously consider when drafting the relevant clause. Making sure that the provision is clear and unambiguous with regard to the binding or non-binding effect of any pre-arbitral tier may preserve the parties from idle procedures as well as the time and costs associated with them.

As a final observation, it should be noted that the Supreme Court was well aware that characterising the non-compliance with a compulsory pre-arbitral ADR procedure as a lack of jurisdiction ratoine temporis rather than as an issue of admissibility was a decision “faute de mieux”. Otherwise, as the Court openly admitted, there would have been no alternative for it to enter into the merits of the challenge, as the violation of a pre-arbitral tier is “certes pas suffisamment grave pour relever de l’ordre public procédural” (“certainly not sufficiently grave so as to amount to a violation of procedural public policy”). But the Supreme Court – rightly in our view – pragmatically considered that the non-compliance with a pre-arbitral tier is closely linked to the arbitration clause as such, and thus sufficiently important to be subject to judicial control by the authority to set aside.

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