Thouvenin Rechtsanwälte
Klausstrasse 33
CH-8034 Zürich

Phone +41 44 421 45 45
Fax +41 44 421 45 00
E-mail info@thouvenin.com

www.thouvenin.com

Arbitration Newsletter Switzerland

Right to be heard – revisited

On February 26, 2014 the Federal Supreme Court made available on its website its most recent decision dealing with the violation of the right to be heard pursuant to Art. 190 (2) (d) PILA[1].

Facts

On March 10, 2006 a Bulgarian company (hereinafter the "Buyer") entered into an agreement with a Finnish company (hereinafter the "Supplier") for the delivery of devices and material required for the modernization of its boiler (hereinafter the "Agreement"). The main purpose of this boiler was to recover chemicals and residual substances and the boiler produces steam from the residual substances.

Under the header "Restriction of the Responsibility" the Agreement provided the following:

"*1. However all other conditions upon the present Contract, by no circumstances the SELLER or whatever partner, sub-supplier, employer or worker of the SELLER will be responsible for any indirect, casual, subsequent, punitive or edifying damages of whatever nature including but unlimited loss of profit, loss of profitable opportunity, loss of income, loss of production, loss of excessive investment of materials and energy, stoppage of the mill, costs of capital, costs of work force, damages of the property, costs for replacement of the capacities etc.*
2. The aggregate liability of Seller to Buyer arising out of this Agreement, whether based on warranty, contract, strict liability or otherwise, shall not exceed thirty (30 %) percent of the contract price.
All liability of SELLER to BUYER, arising out of this Agreement, shall terminate at the expiration of three years after final acceptance."

On March 25, 2009 the Buyer filed a notice of arbitration under the ICC Rules requesting, *inter alia*, the payment of (i) a penalty in the amount of EUR 335'000 for late delivery of technical documentation and devices, (ii) damages amounting to EUR 4'611'047, and (iii) EUR 1'045'000 as reduction in the purchase price.

On March 19, 2012 the three member tribunal issued a partial award in which it ordered the Supplier to pay the Buyer EUR 148'250 for late delivery of technical documentation. The partial award further held that the Buyer had failed to prove that the Supplier had acted grossly negligently.

By a final award dated August 2, 2013 the tribunal ordered, *inter alia*, the following:

a. the Supplier shall pay the Buyer EUR 69'600 plus interest as reduction in the purchase price;
b. the Supplier shall pay the Buyer EUR 552'597 plus interest for costs incurred by the Buyer for the purchase of steam from third parties triggered by the delayed modernization of the boiler;
c. the Buyer shall pay the Supplier EUR 200'000 as partial compensation for the Supplier's party costs.

By an action for annulment filed on August 2, 2013 the Supplier requested the Federal Supreme Court to annul its decision rendered in (a) through (c) above and to remit the case to the tribunal. In doing so, the Supplier contended that the tribunal had violated its right to be heard.

Considerations

After restating that a successful action for annulment generally causes only the annulment of the award, without the Federal Supreme Court deciding on the merits, the Federal Supreme Court restated its well-established principles as to the right to be heard ('due process').

[1] 4A_460/2013 of February 4, 2014, issued in German.

In doing so, it restated that Art. 190 (2) (d) PILA[2] does not require that an award in an international arbitration in Switzerland be reasoned. Nevertheless, a tribunal has, as a minimum, a duty to examine and deal with the issues raised by the parties and, at the same time, relevant to the decision. This duty is violated where - by oversight or by misunderstanding - the tribunal disregards allegations, arguments, evidence and offers of evidence presented by one party and relevant to the decision to be rendered. If an award wholly neglects such elements apparently important for the resolution of the case, either the tribunal or the respondent must justify such omission. It is their task to demonstrate that, contrary to the arguments of the claimant in such annulment action, the omitted elements were not relevant to the decision or, if they were, that they had been at least implicitly rejected by the tribunal.

Nevertheless, the tribunal is not obliged to address every single argument raised by the parties during the arbitration and a violation of the right to be heard cannot arise solely on account of such omission.

Finally, because of the formal nature of the right to be heard the Federal Supreme Court must not decide whether or not the decision would have resulted in a different outcome if the issues had indeed been considered. Instead, it may simply annul the award and remit it to the tribunal for re-consideration.[3]

That said, the Federal Supreme Court then applied these principles to the facts of the present case and found that the tribunal had indeed violated the Supplier's right to be heard in two instances.

The first instance related to the tribunal's order to compensate the Buyer for costs incurred by the purchase of steam from third parties triggered by the delayed modernization of the boiler. The Federal Supreme Court noted that the Supplier had raised, in its submissions, the argument that such costs fell within the scope of the contractual limitation of liability exclusion and, therefore, could not be granted. In addition, the Federal Supreme Court held that the issue of the limitation of liability is relevant to the decision to be rendered. The Federal Supreme Court then held that the tribunal had neither implicitly nor explicitly dealt with the Supplier's limitation of liability argument in the final award and that the only reference to that argument had been in the summary of the parties' contentions. Consequently, the Federal Supreme Court concluded that its decision set out in (b) above had been issued in violation of the Supplier's right to be heard.

The second instance related to the reduction in purchase price pursuant to the tribunal's decision set out in (a) above. In this regard, the Federal Supreme Court held that the tribunal had not dealt with the Supplier's argument that the compensation ordered by way of reduction of the purchase price fell within the scope of the contractual limitation of liability, although relevant to the decision and raised repeatedly in the Supplier's submissions. In fact, the Supplier's contention was, in the final award, mentioned only in the summary of the parties' contentions. Consequently, the Federal Supreme Court found that the Supplier's right to be heard had been violated again and it annulled the related operative part of the award.

Against this background, and upon a relating request by the Supplier, the Federal Supreme Court finally also annulled the tribunal's decision in respect of the cost allocation as set out in its decision (c) above.

Conclusions

Nothing new out of Lausanne! Nevertheless we thought it helpful to briefly report on this decision, squashing an international arbitral award rendered in Switzerland, which is rare. Within the low rate of arbitral awards overturned by the Federal Supreme Court (6.5%[4]) the alleged violation of the right to be heard is the most frequent ground called upon in actions for annulment under Art. 190 (2) PILA but it has a success rate of 39% only[5]. Whilst those figures date from four years ago we have no reason to believe that any significant change in the Court's approach has occurred in the meantime.

[2] "The award may only be annulled: … d) if the principle of equal treatment of the parties or the right of the parties to be heard was violated…".

[3] For further reference see the summary of Supreme Court decisions listed in our newsletter of May 16, 2013.

[4] Felix Dasser, International Arbitration and Setting Aside Proceedings in Switzerland - an Updated Statistical Analysis, ASA Bulletin 2010/1, p. 82 *et seq.*, in particular p. 86.

[5] Ibid.

We do not know the details of the case, in particular how it was presented to the tribunal, sitting under the ICC Rules. Even more so, it remains difficult to envisage how and why this tribunal failed to deal with such a significant point[6]. After having rendered a partial award, denying that the Supplier acted grossly negligently, it seems obvious that the tribunal should then have dealt with the limitation of liability issue to which the Supplier had apparently repeatedly referred to throughout the proceedings. The tribunal did not and now has to do so on remission of the award by the Court. It remains to be seen whether this will provide any benefit to the Supplier because quite often winning the argument of a violation to be heard results in no more than a pyrrhic victory. A tribunal might simply confirm the same award and, even after consideration of the arguments it had failed to deal with in the first award, the result in the confirmed award still remains unchanged[7].

In addition, the right to be heard is of a formal nature only, *i.e.* the Federal Supreme Court will not consider the argument that the result in the award rendered would have been different had the claimant's right to be heard not been violated. Therefore, ingenious counsel frequently use this argument in arbitral proceedings to file further submissions on issues where they consider that the opposite party has raised a new argument to which they should still be granted an opportunity to reply. While a tribunal, in conducting the proceedings, must pay the utmost attention to due process ensuring that it is fully respected, that does not mean that it must accept any and all further pleadings and submissions accompanied by the threat that otherwise that party's right to be heard would be violated. Generally arbitral proceedings are clearly structured, allocating to each party the time at which it can and should bring forward all of its arguments. Therefore, tribunals will have to take a robust approach in each case and they will also be supported by the Federal Supreme Court in its taking a tough stance since not every alleged violation of the right to be heard qualifies for an annulment of the award. The Federal Supreme Court requires to be persuaded that the argument raised by a party which was not dealt with by the tribunal has at least some relevance to its decision making. As in so many cases it is therefore the task of the tribunal to strike the right balance!

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Hansjörg Stutzer
Michael Bösch

For further information please contact:
Hansjörg Stutzer (h.stutzer@thouvenin.com)
Michael Bösch (m.boesch@thouvenin.com)

Exhibit: decision 4A_460/2013

[6] In addition one might also wonder why it took this arbitral tribunal more than four years to render its final award (March 25, 2009 - August 2, 2013).

[7] As in the Cañas Case (BGE 133 III 238), where the CAS tribunal just reissued the first award adding three small sections as to why Delaware law, the issue it had missed in the first award, did not change anything as to its findings in the first award.