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Arbitration Newsletter Switzerland

Don't jump the gun! Lack of jurisdiction in case of failure to comply with pre-arbitration dispute resolution provisions

On March 29, 2016, the Federal Supreme Court published on its website[1] its most recent decision in the field of international arbitration. The Court had to decide on the challenge to a partial award on the jurisdiction of an international arbitral tribunal dealing with the alleged failure to have complied with a pre-arbitration dispute resolution provision providing for conciliation and the question of incompetence *ratione temporis* of such arbitral tribunal.

1. Facts

Two non-Swiss companies, X and Y, entered into four contracts to cooperate in the search for and exploitation of petroleum. The dispute resolution clause of all four contracts provided for the following, identical mechanism:

> *"All differences arising between the Parties […] that cannot be resolved by the Parties, shall in the first instance be the object of an attempt of conciliation under the ADR (Alternative Disputes Resolution) Rules of the International Chamber of Commerce (ICC).*
> *All differences between the Parties […] not resolved by conciliation shall be decided as a last resort by way of arbitration according to the UNCITRAL Arbitration Rules by three (3) arbitrators nominated according to said rules.*
> *[…]" (translation of French wording)*

As differences arose between the parties, Y started conciliation proceedings with the ICC International Centre for ADR (hereinafter "ADR Centre") by submitting a demand for conciliation on 8 September 2014. The parties then agreed that the conciliation was to be governed by the ICC ADR Rules in force as of 1 July 2001, (hereinafter the "ADR Rules") and that a first meeting should take place by way of telephone conference. The appointed conciliator set the conference call for 17 December 2014. Ten minutes before the start time, counsel for Y sent an email to counsel for X indicating that, *inter alia*, other representatives of Y would participate in the conference call. X's counsel opposed this proposal because it had been settled that only the parties' respective counsel and the conciliator would participate in the conference call and X's counsel had not taken any action that would allow any representatives of X to participate. Therefore, X's counsel requested the conciliator either to preserve the agreed mode for the conference call or to postpone it. If the latter, X's counsel requested that a physical meeting should take place in Paris, the place for physical meetings according to the parties' agreement. Y replied that it was never agreed that only the parties' counsel would take part in the conference call but Y did agree to a postponement.

On January 16, 2015, Y initiated arbitration proceedings against X and informed the conciliator that the conciliation has failed due to the behaviour of the other party. X informed the conciliator that there was no reason to declare the conciliation proceeding closed. The conciliator thereafter informed the parties that she could not close the proceedings without having had a discussion as foreseen in article 5(1) ADR Rules and she proposed new dates for a meeting in Paris. Y continued to assert that the conciliation had ended. The conciliator then informed

[1] 4A_628/2015 of March 16, 2016, in French. The decision was rendered by all five members of the First Civil Chamber of the Federal Supreme Court and will be added to its publication of leading cases, which indicates the importance of this decision.

the parties that she interpreted the behaviour of Y as withdrawing from the proceedings and she informed the ADR Centre accordingly. Further, the ADR Centre considered Y to have withdrawn its demand for conciliation. Eventually, the ADR Centre declared the proceedings as terminated due to Y having failed to pay its share of the advance payment.

Meanwhile Y pursued the already-initiated arbitration under the UNCITRAL Arbitration Rules. X objected to the jurisdiction of the arbitral tribunal because of Y's failure to have complied with the pre-arbitration dispute resolution provision providing for conciliation.

The arbitral tribunal consequently bifurcated the arbitration proceedings and, after a double exchange of briefs on the question of the tribunal's jurisdiction, it rendered a partial award accepting jurisdiction. That decision was then challenged by X in the Federal Supreme Court.

2. Considerations

The Federal Supreme Court began its considerations with several preliminary remarks and a description of the arbitral tribunal's as well as the parties' opinions on the issue at hand. It continued by reminding us that it reviews alleged violations of contractual mechanisms constituting a prerequisite to arbitration based on Art. 190(2)(b) PILA[2] and that legal issues which determine the arbitral tribunal's jurisdiction or the lack thereof will be reviewed freely by the court.

The Federal Supreme Court then described the ADR Rules and the ICC's guide to those rules, according to which parties who have agreed on the application of the ADR Rules cannot then withdraw from the proceedings before having had the discussion with the neutral as provided for in article 5(1) ADR Rules.

Turning to the main question, the Federal Supreme Court outlined a four-stage proceeding for its review:

1. Determination of the agreed pre-arbitration mechanism of the parties;
2. Examination of whether the agreed pre-arbitration mechanism of the parties had been correctly conducted;
3. If this was not the case, examination of whether a party's objection to jurisdiction qualifies as abusive; and
4. If this (3) was the case, determination of the appropriate sanction for that party's failure to have complied with the agreed pre-arbitration mechanism.

In the first of the four stages, the Federal Supreme Court analyzed which alternative dispute resolution mechanism the parties had agreed on. For that reason, it interpreted the parties' dispute resolution clause according to general principles applicable to the interpretation of contracts. This means that the court will first seek to establish the mutual subjective intent of the parties. If it is unable to do so, it will seek, by applying the principle of good faith, the meaning that parties could and should have given to their reciprocal manifestations of intent, taking into account all relevant circumstances. By doing so, the Federal Supreme Court concluded, particularly in the light of the clear wording of the clause, that the parties had wanted recourse to arbitration to be conditional on the prerequisite that conciliation, conforming in full with ADR Rules, had taken place.

In its second stage, the Federal Supreme Court examined whether the agreed pre-arbitral conciliation according to the ADR Rules had been correctly conducted. As stated above, the conciliation process in the ADR Rules requires a discussion conforming to Art. 5(1) thereof. Until such discussion has taken place, no party can terminate the conciliation proceeding by withdrawal. The Federal Supreme Court rejected the finding of the arbitral tribunal that the required discussion had taken place by way of exchange of letters and emails. While it was not excluded that the required discussion could have taken place in a staggered manner, it was necessary that the conduct of the ADR procedure should be discussed. In the case at hand, the exchanged letters and emails dealt only with the finding of a possible date for the required discussion and, therefore, no discussion conforming to Art. 5(1) ADR Rules had taken place. The agreed pre-arbitral conciliation procedure had, therefore, not been correctly conducted.

Consequently, the Federal Supreme Court had to examine in its third stage whether X's objection to the arbitral tribunal's jurisdiction had been an abuse of

[2] *"The award may only be annulled: […]*
b) if the tribunal wrongly accepted or declined jurisdiction."

right. Referring to one of its earlier decisions[3], the court held that a challenge to an award based on an alleged failure to have complied with the requirements of the pre-arbitration conciliation was an abuse of right where the challenging party had not requested such conciliation before the arbitration proceeding; this was so because the principle of good faith prohibits a party discovering an error in the proceedings from waiting until the end of the proceeding to raise an objection in this regard. But the court then pointed out that the particular circumstances of that earlier case, *inter alia* that there had hardly been any likelihood of finding a solution in conciliation, meant that the party challenging the award preferred to arbitrate and that it had only raised that issue in its challenge to the award. The court continued by stating that this decision was not uncontested; scholars have argued that it seems inappropriate to have a general rule that the simple inactivity of a respondent is sufficient to cure claimant's violation of the conciliation clause. The court then indicated that it was not necessary to deal with the mentioned scholarly authority because the present case was very different from the earlier one because the party challenging the award had actively taken part in the conciliation and had immediately raised an objection to the jurisdiction of the tribunal after the other party had initiated arbitration proceedings. In addition, the court rejected the argument that there had been no likelihood of success in a new conciliation and it noted that the challenging party had not unduly obstructed or blocked the conciliation. It followed that X had not abused its right by objecting to the arbitral tribunal's jurisdiction.

In its final stage, the Federal Supreme Court determined the appropriate sanction for the failure to have complied with the pre-arbitration dispute resolution provisions. The court first pointed out that this question is highly controversial: should it be a claim for damages or for the inadmissibility of the initiated claim, resulting in the closure of the arbitration proceedings? The court analyzed these options and rejected both given that neither of them seemed to be the appropriate sanction. In line with the majority view of Swiss scholars, the court declared that the appropriate sanction in such cases is to suspend the arbitration proceedings combined with the fixing of a deadline for the parties to conduct the conciliation.

Consequently, the Federal Supreme Court upheld the challenge, annulled the award and ordered the suspension of the arbitration proceedings until the conciliation procedure had been concluded according to the ADR Rules. However, the further modalities of the suspension, in particular a time limit of the suspension, were left to the arbitral tribunal.

3. Conclusions

In addition to its previous decision referred to by the Federal Supreme Court[4], this decision has to be read, together with its 2014 decision which also addressed the topic of agreed pre-arbitration proceedings[5]. In that case the question had been whether Art. 20 of the FIDIC Conditions of Contracts would deprive an arbitral tribunal of jurisdiction to hear a case which had not gone through the Dispute Adjudication Board ("DAB") procedure. The answer in this case was that, under its specific circumstances[6], such insistence on DAB proceedings would have amounted to an abuse of right. The present case had quite a different factual background and, consequently, its outcome was different.

Moreover, this new decision clarifies an issue which had not been addressed in the earlier decisions, namely what should the sanction be if claimant failed to comply with its obligation to mediate first before initiating arbitration proceedings? With convincing arguments, the Federal Supreme Court has rejected both (i) the possibility of an award of damages and (ii) the option to reject the claim. The first one because it would be almost impossible to substantiate such damages and the second because the arbitral tribunal would become *functus officio* and a new arbitral tribunal would have to be constituted in order to hear the case once the mediation agreed upon by the parties had been concluded. In addition, the claim might face the risk of being time-barred in the meantime. Therefore, the Federal Supreme Court has emphatically and pragmatically concluded that the

[3] 4A_18/2007, consid. 4.3.3.1.

[4] See footnote 3 above.

[5] 4A_124/2014, published on 24 September 2014, rendered by all five members of the First Civil Chamber as well, but it has not been published in the collection of leading cases.

[6] Over a period of more than 18 monthes the parties were unable to constitute the Dispute Adjutication Board.

suspension of the arbitral proceedings was not only the appropriate solution but, indeed, also the only reasonable solution, one which properly balanced the interests of the parties.

The three decisions referred to above now give every practitioner a clear picture as to when pre-arbitration proceedings are mandatory and, in particular, what the sanctions will be if such proceedings are not duly followed.

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