Tribunal's jurisdiction to hear claims for damages over breach of licence agreement upheld (Swiss Supreme Court)

by *Prof. Dr Nathalie Voser* (Partner) and *Luka Groselj* (Senior Associate), Schellenberg Wittmer Ltd

Legal update: case report | Published on 08-Jul-2020 | Switzerland

In *Decision 4A_12/2019*, the Swiss Supreme Court upheld the decision of an arbitral tribunal in which it had found that it had jurisdiction to hear a claim for damages in relation to a licence agreement. The Supreme Court also found that the applicant's right to be heard had not been breached and that the award did not violate substantive public policy.

Speedread

In a recently published French-language decision, the Swiss Supreme Court rejected an application to set aside a final award in which the arbitral tribunal had accepted jurisdiction over a licensee's direct claim for compensation against the licensor, as well as over claims relating to loss of profits that a sub-licensee had sustained due to the licensor's breach of the licence agreement.

The case concerned a licence agreement that conferred the licensee the worldwide exclusive right to operate seafood bars in airports and train stations. The agreement contained an arbitration clause providing for arbitration with a Geneva seat.

In practice, the licensee, a British multinational catering and travel retail group, sub-licensed the right to establish seafood bars to its local affiliate. Upon expiration of the first term of a concession to run the seafood bar in a Swiss airport, the airport refused to renew the concession and awarded it to the licensor who had also submitted an offer. The licensee initiated arbitral proceedings against the licensor for breach of the exclusive rights under the licence agreement, namely arguing that the licensor had engaged

into direct discussions with the airport and had failed to disclose that it had conferred exclusive rights to operate seafood bars to the licensee. The various heads of claim contained, among other things, requests for compensation for the fees and royalties the sub-licensee would have paid had the concession been prolonged for one additional term and loss of profits sustained by the sub-licensee who was not party to the licence agreement. The arbitral tribunal accepted jurisdiction and upheld the licensee's claims. With regard to the loss profit claim, this was based specifically on the holding that the parties had agreed on a third-party beneficiary clause in favour of the sub-licensee.

The licensor applied to the Supreme Court to set aside the award on the ground that the arbitral tribunal had wrongly accepted jurisdiction with regard to the loss of profits claim insofar as the sub-licensee was a non-signatory third-party to the licence agreement and the arbitration clause contained therein. It also asserted that its right to be heard had been violated and that the award breached substantive public policy.

In its decision, the Supreme Court rejected all of the licensor's arguments. In particular, it upheld the arbitral tribunal's jurisdiction on the ground that the arbitration clause encompassed the licensee's right to bring direct claims against the licensor for damages incurred by its sub-licensee. (*Decision 4A_12/2019 (17 April 2020)*.)

Background

Article 190 of the Swiss International Law Act (PILA) reads as follows:

> "The award may only be challenged:
> […]
> (b) if the arbitral tribunal wrongly accepted or declined jurisdiction
> […]
> (d) if the principle of equal treatment of the parties or the right of the parties to be heard was violated
> (e) if the award is incompatible with public policy."

Article 112(1) of the Swiss Code of Obligations (CO) provides that:

> "A person who, acting in his own name, has entered into a contract whereby performance is due to a third party is entitled to compel performance for the benefit of said third party."

For further information on arbitration in Switzerland, see *Practice note, Arbitration in Switzerland*.

Facts

The underlying dispute concerned a licence agreement between a Geneva company (Licensor) who had developed a specific seafood bar concept and owns the brand and logos related to it, and an English company (Licensee) who operates food and beverage stalls in airports and railway stations all around the world (License Agreement).

Under the terms of the Licence Agreement, the Licensor granted the Licensee the worldwide exclusive rights to establish and operate seafood bars in airports and railway stations. The Licensee was, in turn, also entitled to grant sub-licenses to its subsidiaries with regard to the seafood bars, allowing them to establish and operate seafood bars. Under the Licence Agreement, the Licensor undertook to cooperate in good faith with either the Licensee itself or with its subsidiaries in any tender process for the seafood bars falling within the Licence Agreement's scope. The Licence Agreement was governed by Swiss law and included an arbitration clause providing for arbitration in Geneva in accordance with the Swiss Rules of International Arbitration.

The Licensee sub-licensed certain rights to its Swiss subsidiary (Sub-Licensee) in accordance with the requirements set out in the Licence Agreements (Sub-Licence Agreement). The Licensor was not party to this Sub-Licence Agreement, which contained a separate arbitration clause. In the course of 2009, Geneva International Airport awarded the Sub-Licensee a concession to open an outlet and later renewed the concession until the end of August 2015.

In summer 2014, the airport started a new tender process with regard to its food and beverage lots for the 2015-2020 period. The tender process did not concern the lots where the Sub-Licensee already operated because the airport was keen to keep the Licensor's brand and was willing to negotiate directly with the Licensor as the brand owner. The Licensee submitted offers for two other lots.

The airport eventually awarded the concession to operate the seafood bar for the 2015-2020 period to the Licensor, while the Licensee's offers were declined. As a result, the Licensee raised claims against the Licensor asserting that, by conducting direct discussions with the airport, the Licensor had infringed the Licensee's exclusive rights to operate the seafood bar concept and to develop the related brand. On these grounds, the Licensee terminated the Licence Agreement in December 2019, invoking its right of early termination.

The Licensee initiated arbitration proceedings against the Licensor requesting compensation for breach of the exclusive rights under the Licence Agreement, consisting of Sub-License fees and royalties, as well as loss of profits.

The issue to be resolved was whether the Licensee could avail itself under the Licence Agreement of the Sub-Licensee's rights and obligations under the Sub-License Agreement. The arbitral tribunal found that:

- The Licensor had breached the Licensee's exclusive rights in that it misrepresented the existence of the Licensor's own exclusive rights when it engaged in direct discussions with the airport to take over the seafood bar concession.
- The Licensor and the Licensee had agreed on a contract for the benefit of the Sub-Licensee (who was a third-party to the Licence Agreement) pursuant to Article 112(1) of the CO.
- As a result, the Licensee had a direct right to claim compensation from the Licensor for damages incurred by the Sub-Licensee for breach of the exclusive rights set forth in the Licence Agreement.

Among other things, it ordered the Licensor to pay:

- Damages, including CHF 250,000 for foregone fees and royalties the Licensee would have earned, based on the Sub-Licence Agreement, had the Sub-Licensee been in a position to operate the seafood bar during the 2015-2020 period.

- CHF 1.6 million corresponding to the loss of profits incurred by the Sub-Licensee (that is, the Licensee's Swiss subsidiary) for having been prevented from operating the seafood bar during the 2015-2020 period.

The Licensor challenged the award before the Supreme Court under Article 190(a) of the PILA arguing that the arbitral tribunal wrongly asserted jurisdiction as concerns the loss of profits claim. It also invoked a violation of its right to be heard and a breach of substantive public policy pursuant to Articles 190(d) and (e), respectively.

Decision

The Swiss Supreme Court rejected the Licensor's application, concluding that the arbitral tribunal was correct to assert jurisdiction. It also found that the Licensor's right to be heard had not been violated and that the award was not tantamount to a breach of substantive public policy.

Jurisdiction: Licensee's claim for damages suffered by Sub-Licensee within scope of arbitration clause

The Licensor argued that the Licensee's loss of profits claim related to damages essentially suffered by the Sub-Licensee, which is a non-signatory third-party to the Licence Agreement. As a result, it contended that the arbitral tribunal had wrongly accepted jurisdiction.

The Supreme Court recalled that when an arbitral tribunal rules on its jurisdiction, it first needs to define the objective and the subjective scope of the arbitration agreement. Put differently, it must determine what parties are bound by the arbitration agreement and what disputes the arbitration agreement covers. In that regard, the Supreme Court referred to previous decisions and underlined that being party to an arbitration agreement and having standing to sue or be sued are two separate issues: the former is sufficient to establish jurisdiction, while the latter is a matter concerning the merits of the case.

Against that backdrop, the Supreme Court noted that the question as to whether a party may request relief in lieu of a third-party beneficiary was a substantive matter. More precisely, the Supreme Court held that an arbitral tribunal has jurisdiction to determine such a question as long as the parties are signatories to the agreement containing a clause referring any disputes in relation to the agreement to arbitration (see paragraph 2.3 in *Decision 4A_44/2011*, discussed in *Legal update, Third party beneficiaries entitled to rely on arbitration clause in contract between promisor and promisee*). In addition, it added that where the scope of an arbitration agreement covers disputes relating to damages for breach of contract, a party may claim either for the damages it incurred itself or those a non-signatory third-party suffered further to the breach (or both). Either way, the dispute falls within the scope of the arbitration agreement.

The Supreme Court proceeded to examine the arbitration agreement set out in the Licence Agreement. It found it "obvious" in that regard that the dispute between the Licensor and the Licensee with respect to the Sub-Licensee's loss of profits fell squarely within the scope of the arbitration agreement at hand. That agreement provided that "any dispute, controversy or claim arising out of or in relation to [the License Agreement], including the validity, invalidity, breach or termination thereof, shall be resolved by arbitration". The Supreme Court underscored that the determination of whether or not the Licensee's claim with regard to its Sub-Licensee's damages was well-founded, on the basis of a contract to the benefit of a third-party pursuant to Article 112(1) of the CO, pertained to the merits of the case. As such, the issue was not subject to the Supreme Court's review in setting-aside proceedings under the plea of lack of jurisdiction. The fact that the arbitral tribunal had addressed it in the section of the award dealing with the jurisdiction of the tribunal did not change anything to this outcome.

The Licensor lastly contended that because the Licensee assigned the rights and obligations under the Licence Agreement to the Sub-Licensee in their entirety, the Licensee's claims should have been dismissed for lack of standing to sue. While acknowledging that as a general principle the transfer of an arbitration clause further to the assignment of the contract would result in the Licensor's lack of standing, the Supreme Court dismissed the argument and held that in the instant case neither the award nor the Licence Agreement contained any indication that the Licence Agreement had been assigned in its entirety to the Sub-Licensee. Therefore, the Supreme Court found that there was no ground to set aside the award on the basis of an alleged lack of jurisdiction.

Right to be heard (due process): issues not ignored when dissenting arbitrator discusses them

The Licensor argued that its right to be heard was violated, among other things, because the arbitral tribunal had ignored relevant evidence. It mainly referred to the dissenting opinion that had been issued by one of the arbitrators. It put forward that the arbitral tribunal had failed to consider a witness testimony, as well as a letter to the airport and other pieces of evidence on record that were purportedly material to the outcome of the case.

The Supreme Court dismissed these arguments mainly on the ground that the award was issued subject to a dissent of one of the arbitrators that dealt with some, if not all, of the Licensor's grievances in relation to the pieces of evidence mentioned above. Referring to an old precedent (see *Decision 4P.74/2006*, paragraph 5.3), the Supreme Court considered that the points set out in the dissenting opinion must have been discussed amongst the members of the arbitral tribunal during the deliberations, at least in their essential aspect, notwithstanding the fact that the dissenting arbitrator stated that "several pieces of evidence were not considered". The Supreme Court held that essentially the phrase "not considered" was a criticism on the manner in which the arbitral tribunal assessed the evidence or applied the law in the instant case. However, under the longstanding case law of the Supreme Court, such shortcomings, assuming they occurred, are in any event not subject to review in setting-aside proceedings. The Supreme Court consequently declared the Licensor's plea to be unfounded.

Substantive public policy: no manifest abuse of right

As a final argument, the Licensor claimed that the Licensee committed a blatant abuse of right by invoking its exclusive rights to operate the seafood bars for the period 2015-2020 only in order to prevent a third-party from operating the seafood bar in the airport, while it did not intend to itself use its exclusivity rights. The Licensor argued that the Licensee exercised its rights in a manner that was incompatible with the reason the exclusive rights were afforded in the first place.

The Supreme Court underlined that, generally, an award is contrary to substantive public policy if it violates fundamental substantive legal principles and thus disregards essential and widely recognised values. Such principles include:

- *Pacta sunt servanda* (agreements must be kept).
- The principle of good faith.
- Prohibition of abuse of rights.
- Prohibition of expropriation without compensation.
- Prohibition of discrimination.

Finally, the Supreme Court made it clear that it only vacates an award if its result is contrary to public policy.

In this case, the Supreme Court referred to the findings of the arbitral tribunal which had rejected the Licensor's abuse of right argument on the ground that it was put forward very late in the proceedings, namely in the Licensor's post-hearing brief, a fact that in itself cast some doubt on the legitimacy of the argument. The Supreme Court dismissed the plea, emphasising that the Licensor's argument ran counter to the findings of the arbitral tribunal on the issue of abuse of right and that it criticised the arbitral tribunal's interpretation of the Licence Agreement. As a result, it was not open to the Supreme Court's review.

Comment

A number of issues are worth noting.

This case appears to be the first decision in which the Supreme Court clarifies that when the promisee enters into an agreement (here, the Licence Agreement) in its own name with the promisor and that this agreement contains a provision that the promisee's rights can be performed by a third-party, such as an affiliate company, the arbitral tribunal has jurisdiction to decide compensation claims from the promisor for damages suffered by a third-party due to breaches of the agreement. In practice, parties having chosen Swiss substantive law would do well to bear the theory of the "contract for the benefit of a third-party", pursuant to Article 112(1) of the CO, in mind. This concept, which describes the way an agreement must be performed (as opposed to a particular type of agreement), may apply as a default solution in industries in which subcontracts are common. Essentially, it entitles the contracting party who has been promised a particular performance benefitting a third-party to itself claim non-performance and breach of contract regarding the obligations towards the third-party beneficiary.

The decision is a cautionary reminder for the holding that the Supreme Court distinguishes jurisdiction (being a party to an arbitration agreement) and standing to sue or be sued. The Supreme Court had already clarified that it clearly separates issues of substantive law from those pertaining to jurisdiction and that the question of standing is a matter of substantive law, distinguishable from the question of whether an arbitration agreement sufficient to establish jurisdiction of the arbitral tribunal exists (see *Decision 4A_562/2015*, paragraph 3).

Finally, the case highlights the high threshold for vacating an award based on an alleged violation of the right to be heard. In particular, the arbitral tribunal's assessment of evidence, even if wrong and untenable, is not subject to review by the Supreme Court. The same holds true for an incorrect application of the law or of the contract, unless the applicant can establish that these errors are contrary to public policy pursuant to Article 190(2)(e) PILA, which is rarely the case.

Case

Decision 4A_12/2019 (Swiss Supreme Court) (17 April 2020).

END OF DOCUMENT

Related Content

Topics

Arbitral Awards and Challenges
Jurisdictional Issues - Arbitration
Arbitration Agreements

Practice notes

Arbitration in Switzerland • Maintained

Enforcing arbitration awards in Switzerland

Legal update: archive

Third party beneficiaries entitled to rely on arbitration clause in contract between promisor and promisee • Published on 02-Jun-2011