Award confirming success fee arrangement not in violation of public policy although decision may contradict settled law (Swiss Supreme Court)

by Prof. Dr. Nathalie Voser (Partner) and Benjamin Gottlieb (Associate), Schellenberg Wittmer

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In decision 4A_125/2018, the Swiss Supreme Court dismissed a request by a former client of a Swiss law firm to set aside an award which confirmed that the firm could receive a contingency fee for representation in arbitral proceedings, based on the argument that such fee arrangements were in violation of public policy.

Speedread

In a German-Language decision, the Swiss Supreme Court rejected a petition to set aside an award for an alleged violation of public policy.

A company retained a Swiss law firm to act for it in ICC arbitration proceedings. The engagement letters between the company and the law firm provided for a reduced hourly rate and a success fee. A dispute between the company and the law firm was referred to arbitration, with the sole arbitrator finding that the success fee arrangement was valid. The company challenged the award.

Although the Swiss Supreme Court held that the sole arbitrator had deviated from the Supreme Court’s standing case law regarding success fees, it held that neither the mismatch between the performance-related and the non-performance-related part of the remuneration, or the potential conflict of interests caused by the remuneration mechanism, amounted to a public policy violation.

The decision is to be welcomed, in particular in view of the very restrictive earlier decision of the Supreme Court regarding the validity of success fee arrangements of lawyers practising in Switzerland (see decision 4A_240/2016 of 13 June 2017 (BGE/ATF 143 III 600)). That decision received harsh criticism, especially from within the Swiss arbitration community, as it severely restricted the economic freedom of Swiss lawyers as compared with colleagues from abroad. This new decision confirms that, within the boundaries of public policy and the applicable bar rules, international and Swiss law firms enjoy an equality of arms, when it comes to alternative fee arrangements with their clients regarding international arbitration proceedings. (*Decision 4A_125/2018 (26 July 2018).*
**Background**

Article 190(2)(e) of the Private International Law Act (PILA) provides that an award will be set aside if the award is incompatible with public policy.

**Facts**

In 2012, a Portuguese company (A) retained the services of a Swiss law firm (B) to represent it against D in two ICC arbitration proceedings. To that end, the parties entered into two engagement letters which were subject to Swiss law and provided for a reduced hourly rate and a success fee. The relevant clauses in the two contracts read as follows:

- **First arbitration.** "A success fee consisting of 15% on any (principal) amount claimed by and awarded to A (ignoring any successful set-off defence)". This clause further contained a cap for the success fee at CHF 1 Million.

- **Second arbitration.** "A success fee consisting of 15% on (i) any amount claimed by and awarded to A (ignoring any successful set-off defence) applies."

  "The success fee becomes payable in addition to the reduced blended hourly rate. The amounts in question do not include any compensation for attorney's fees or other costs of arbitration and apply irrespective of whether the amount is determined by a decision of settlement.

  In the event of a full settlement disposing of all claims in the arbitration, the success fee is reduced to 4% calculated based on the difference between the aggregate amount in dispute (total of claim, counter-claim and sett-off defence).

  Should B consider a settlement offer made by D to be appropriate, it may request A to consent to such offer. Should A not wish to agree to the settlement offer, B in its own discretion may opt to be compensated in line with this success fee arrangement as if the settlement offer had been accepted.

  In no event may (i) the success fee be negative or (ii) exceed CHF 1,500,000 or its equivalent in other currencies (success fee cap)."

The engagement letters further provided for arbitration with seat in Zurich, Switzerland, pursuant to the Swiss Rules of International Arbitration.

On the basis of the engagement letters, B represented A in the two arbitration proceedings. The amount in dispute in the first arbitration amounted to EUR 3,092,623 (A's claim) and EUR 1,809,257 (counterclaim by D). In the second arbitration, the amount in dispute was EUR 10,237,171 (A's claim) and EUR 147,212,967.38 (counterclaim by D). In April 2014, A and D reached an overall settlement for both arbitration proceedings, according to which A was to pay D a total of EUR 11,512,134.38.

B subsequently invoiced A for unpaid hourly fees of CHF 99,995.30 and CHF 68,637.30, and the payment of what it considered to be the success fee, which it already reduced from CHF 2,500,000 to CHF 2,000,000. A disputed the invoice. Negotiations among the parties remained unsuccessful, notwithstanding the intervention of the fee commission of the Zurich Bar Association.
B commenced arbitration proceedings before a sole arbitrator and was ultimately awarded a total sum of approximately CHF 1.6 million. In reaching its decision, the sole arbitrator examined the much-discussed decision of the Supreme Court on the validity of success fee arrangements under Swiss law (decision of the Swiss Supreme Court 4A_240/2016 of 13 June 2017 (BGE/ATF 143 III 600)), but decided to deviate from that decision regarding the admissible maximum sum of a success fee.

A challenged the award before the Swiss Supreme Court, arguing that the sole arbitrator’s interpretation of the fee arrangement violated the principle of lawyers’ independence for both the amount of the success fee and the differing mechanisms in case of termination of the proceedings through an award or a settlement. According to A, the principle was disregarded in such a fundamental manner that the award violated public policy.

**Decision**
The Swiss Supreme Court rejected the challenge, dismissing the alleged violation of public policy invoked by A.

By way of an introductory comment, the Swiss Supreme Court examined the fee arrangements in the engagement letters, in particular, the engagement letter entered into for the second arbitration. It noted that the sole arbitrator had concluded that in the case of an amicable settlement of the arbitration proceedings, it was almost guaranteed that B would have received the maximum amount of the success fee, whereas reaching the maximum amount in case of a termination of the arbitral proceedings through a final award was much less probable (only if A would have succeeded with 97% of its principle claim).

Against this background, the Swiss Supreme Court queried whether such an arrangement could really be viewed as a success fee agreement, given that reaching a settlement of the claims between A and D provided a very strong economic incentive for A’s lawyers, in this case, B. The court explicitly concluded that such an arrangement is questionable in view of the applicable rules for lawyers practising in Switzerland. This critique notwithstanding, the Swiss Supreme Court went on to state that irrespective of a potential violation of these rules, it could scrutinise the sole arbitrator’s award solely from the viewpoint of the exhaustive grounds for setting aside arbitral awards provided for in article 190(2) of the PILA.

Against this background, the Swiss Supreme Court analysed its previous case law (which was rendered in connection with enforcement proceedings) regarding to the compatibility of success fee arrangements of lawyers and their clients with public policy:

- In a decision rendered in the context of enforcement proceedings of an award in 2014 (decision 5A_409/2014 of 15 September 2014, discussed in Legal update, Swiss Supreme Court confirms narrow interpretation of grounds for refusing recognition and enforcement of foreign arbitral awards), a foreign award regarding a success fee of USD 1,837,500 (corresponding to approximately 2% of the total settlement amount) was considered to be compatible with public policy.

- In a further decision, the Swiss Supreme Court held that an award regarding a fee arrangement, according to which the fee amounted to 30% of the awarded amount, did not constitute a violation of public policy (decision 5P.201/1994 of 9 January 1995).

- Finally, a success fee of over CHF 6,500,000, corresponding to approximately 6.5% of the claim, was held to be compatible with public policy (judgment 5P.128/2005 of 11 July 2005), even though the fee arrangement in question was a so-called "pactum de quota litis" (an agreement providing for a share of the proceeds of a case as the sole remuneration of the lawyer), which is prohibited in Switzerland.
In the present case, the Swiss Supreme Court found that regarding the first arbitration, the fee arrangement was not problematic, given the proportion between the fixed and variable parts of B’s fee and the fact that the arrangement did not depend on how the proceedings were terminated (award or settlement). With respect to the fee agreement for the second arbitration, the Supreme Court found that, as the fee only amounted to less than 2% of the claim, the award did not violate fundamental legal principles, which according to the prevailing view in Switzerland should form the basis of any legal system. Neither the mismatch between the performance-related and the non-performance-related part of the remuneration nor the potential conflict of interest caused by the remuneration mechanism could justify a public policy violation.

Accordingly, the Swiss Supreme Court dismissed the challenge.

**Comment**

The present decision of the Swiss Supreme court may at first sight seem surprising, since the success fee arrangement as such would have most likely been invalid under Swiss law. However, the fact that the sole arbitrator decided not to follow the standing case law of the Supreme Court in this regard, was not in itself sufficient ground for setting the award aside.

The decision recalls previous case law regarding success fees in the context of arbitration proceedings. It is worthwhile pointing out, in particular for non-Swiss practitioners, that, in principle, even fee arrangements which would be prohibited under Swiss law do not amount to a ground for setting an award aside or not enforcing an award which granted a claim for payment of such fees.

The decision is to be welcomed, in particular in view of the very restrictive decision of the Supreme Court regarding the validity of success fee arrangements of lawyers practising in Switzerland (decision 4A_240/2016 of 13 June 2017 (143 III 600)). That decision received harsh criticism, especially from within the community of Swiss arbitration practitioners, as it severely restricted the economic freedom of Swiss lawyers as compared with colleagues from abroad. This new decision confirms that, within the boundaries of public policy and the applicable bar rules, international and Swiss law firms enjoy an equality of arms, when it comes to alternative fee arrangements with their clients regarding international arbitration proceedings.

**Case**

*Decision 4A_125/2018 (26 July 2018).*
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