Swiss Supreme Court partially sets aside ICC award on grounds of extra petita

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

Legal update: case report | Published on 15-Jan-2020 | European Union, Switzerland

In *Decision 4A_294/2019*, the Swiss Supreme Court partially granted the parties' respective applications to set aside an International Chamber of Commerce (ICC) award on grounds of *extra petita*.

Speedread

In a recently published German-language decision, the Swiss Supreme Court partially granted the parties' respective applications to set aside an International Chamber of Commerce (ICC) award on grounds of extra petita.

The court found that the arbitral tribunal had gone beyond the scope of the parties' prayers for relief by essentially treating the claimant's requests for declaratory relief as claims for performance, that is, for payment of damages.

Further, the court rejected the claimant's argument that the award was incompatible with substantive public policy because the arbitral tribunal had awarded contractual penalties, despite performance having become impossible.

This case presented the Swiss Supreme Court with the rare opportunity to rule on an *extra petita* application, which also led to the even rarer occurrence of a partial setting aside of an arbitral award. The decision serves as a reminder that arbitrators are prohibited from "correcting" the parties' prayers for relief. A tribunal may be tempted to do so if it is unclear why a party requested "only" declaratory relief instead of payment, or where the absence of a payment claim may even seem nonsensical. However, it is up to the parties and their counsel alone to decide what the tribunal should rule upon. (*Decision 4A_294/2019 (13 November 2019)*.)

Background

Article 190(2) of the Swiss Private International Law Act (PILA) allows a final award to be set aside for a limited number of reasons. For example, a setting aside application may be brought if the arbitral tribunal's decision went beyond the claims submitted to it (*ultra* or *extra petita*) or if the arbitral tribunal failed to decide one of the items of the claim (*infra petita*) (*Article 190(2)(c), PILA*), or if the award is incompatible with Swiss public policy (*Article 190(2)(e), PILA*).

Article 163(2) of the Swiss Code of Obligations (CO) provides that a contractual penalty may not be claimed where its purpose is to reinforce an unlawful or immoral undertaking or, unless agreed otherwise, where performance has been prevented by circumstances beyond the debtor's control.

Facts

In 2015, a company located in Israel (A) and companies based in Turkey (B and C) entered into an agreement related to the design, manufacturing and delivery of armoured vehicles. That agreement contained an arbitration clause providing that disputes be resolved by the International Chamber of Commerce (ICC). In December 2017, following various disagreements throughout the execution of the project, A declared partial avoidance of the agreement and initiated arbitration proceedings against B and C under the ICC Rules.

In its prayers for relief, A, as claimant, submitted, among other things, that the tribunal should declare the respondents, B and C, severally and jointly liable to compensate A for:

- Any and all damages incurred as a result of B and C's contractual breaches resulting in A's partial avoidance of the agreement (A's Prayer 1).
- Any and all damages (including disgorgement of profits) to be incurred or, as an alternative, any and all damages to be incurred plus any and all profits to be made by B and C as a consequence of B and C's use of A's IP rights and know-how related to the armoured vehicles in violation of the agreement (A's Prayer 2).

In their prayers for relief, B and C disputed the validity of the partial avoidance and filed counterclaims. B and C submitted, among other things, that A should compensate B and C for damages and losses incurred corresponding to a total amount of over USD 8.5 million.

In its award of 6 May 2019, the arbitral tribunal seated in Zurich issued, among other things, the following orders:

- The respondents are jointly and severally liable to compensate the claimant in the amount of USD 1,605,521.37 for damages incurred as a result of the respondents' contractual breaches of the agreement (Order 1).
- The respondents have infringed the claimant's IP rights and know-how in relation to the vehicles (Order 2).
- The respondents are not liable to compensate the claimant in respect of such infringement of IP rights and know-how related to the vehicles (Order 3).
- The claimant is liable to compensate the respondents for damages and losses (including interest thereon) suffered by the respondents as a consequence of the claimant's breaches. Such losses and damages have been paid in their entirety by virtue of the respondents' declaration of set-off and their draw-down of excess amounts under the claimant's Bank Guarantee (Order 4).
- In light of the determination in Order 4, the respondents are liable to reimburse to the claimant in the amount of USD 1,270,659.10 (Order 5).

A, as well as B and C, filed applications with the Swiss Supreme Court to set aside the award. Both sides argued that the award violated the principle of *ne eat iudex ultra petita partium* (the rule that the arbitral tribunal is bound by the parties' submissions and prayers for relief when rendering its decision). In addition, A submitted that the award was incompatible with substantive public policy.

Decision

The Swiss Supreme Court consolidated the two setting aside proceedings and partially granted the parties' respective applications to set aside the ICC award.

Extra petita

The court referred to its established case law whereby the principle of *ne eat iudex ultra petita partium* is not violated if the arbitral tribunal's legal assessment of the claims partially or entirely differs from the parties' reasoning, provided that the arbitral tribunal's findings are covered by the prayers for relief. However, the arbitral tribunal is bound by the subject and amount of the prayers for relief, particularly if a party has qualified or limited its claims in its prayers.

A argued that in its Prayer 1, it had sought a declaration by the arbitral tribunal confirming B and C's liability for certain breaches of contract, whereas the arbitral tribunal had instead awarded A damages (Order 1).

B and C submitted that A had no legitimate interest in bringing a setting aside application related to an order under which it had been granted damages.

However, the Supreme Court rejected B and C's argument that A lacked the required legitimate interest to file a setting aside application. The court considered that the arbitral tribunal had limited the amount of awarded damages to USD 1,605,521.37. Due to the res judicata effect of the award, it would be impossible for A to claim for a higher amount of damages in any future proceedings – an option that would have remained open to A had it been awarded the requested declaratory relief (instead of damages).

Against this background, the Swiss Supreme Court found that the arbitral tribunal, instead of deciding A's request for declaratory relief, had decided a claim for performance, that is, for payment of damages. However, A had not filed a payment claim in the arbitral proceedings. Hence, the court found that the arbitral tribunal's order indeed constituted a decision *extra petita*.

With regard to A's Prayer 2 and the arbitral tribunal's Order 3, A submitted that it had sought a declaration by the arbitral tribunal confirming B and C's liability for unlawful use of A's intellectual property rights and know-how. With reference to the arbitral tribunal's confirmation that B and C had breached the agreement in that regard (Order 2), A submitted that such breach of contract would have had the direct legal consequence that B and C were liable for any damage incurred as a result of their breach. However, A submitted that instead of ending its analysis there and granting A's request for declaratory relief, the arbitral tribunal had proceeded to assess whether A had actually suffered damage (which the tribunal found not to be the case). However, according to A, contrary to performance claims, the existence of damage is precisely not a precondition for the granting of declaratory relief. A submitted that the arbitral tribunal had, therefore, decided *extra petita* by treating A's claim for declaratory relief as a claim for performance (in form of payment of damages), which the tribunal then rejected due to a lack of proof of damage.

The Supreme Court noted that A had not shown why the arbitral tribunal's decision should be considered a departure from A's request for declaratory relief in favour of a decision ordering performance. The court further observed that A had not argued that the arbitral tribunal would not have been permitted to order negative declaratory relief. Rather, the Supreme Court considered that by arguing that the requested declaratory relief would not have been subject to any further preconditions other than a breach of contract, A criticised the arbitral tribunal's reasoning of the award. Hence, A had not demonstrated a violation of the principle of *ne eat iudex ultra petita partium*, but simply passed criticism on the arbitral tribunal's application of the substantive law, which is not a permissible ground for appeal

before the Swiss Supreme Court. Therefore, the court rejected A's request for a setting aside of the arbitral tribunal's Order 3.

In their prayer for relief, B and C had raised a counterclaim requesting that A be ordered to pay damages in the amount of USD 8,504,553.74. The arbitral tribunal confirmed A's liability for its contractual breaches, but with regard to the amount of damages considered that B and C's claim had been fulfilled by means of a set-off declared by B and C. B and C submitted that the arbitral tribunal's corresponding Orders 4 and 5 were rendered *extra petita* and must be set aside.

The Supreme Court found that the consideration of the set-off and the resulting fulfilment of the claim did not require a claim for performance by A in the arbitral proceedings. Rather, the arbitral tribunal's finding under Order 4 was a result of the substantive assessment of B and C's claim for damages. Therefore, the court held that the arbitral tribunal had decided within the ambit of B and C's prayer for relief and not *extra petita*.

However, with regard to Order 5, the Supreme Court found that the arbitral tribunal had decided *extra petita* by awarding A the surplus amount that remained after B and C's set-off, that is USD 1,270,659.10, as this would have indeed required a payment claim by A. Therefore, the court granted B and C's application and set aside the arbitral tribunal's Order 5.

Public policy

Rejecting A's application, the Supreme Court noted that the arbitral tribunal had awarded B and C contractual penalties based on A's non-delivery of the armoured vehicles. A argued that the termination of the contract between C and the end user of the vehicles had rendered the required end user certificate invalid and therefore, contractual delivery had become impossible. A submitted that the arbitral tribunal's decision to award B and C contractual penalties constituted an evident and grave violation of Article 163(2) of the CO and was, therefore, incompatible with Swiss substantive public policy (*Article 190(2)(e), PILA*).

The Supreme Court recalled its established case law whereby a violation of public policy is only assumed where an award violates fundamental principles of law and is irreconcilable with essential and widely recognised values, which, based on prevalent opinion in Switzerland, lie at the core of every legal system. Moreover, the court noted that an award will only be set aside if its result, and not only its reasoning, is incompatible with public policy.

The Supreme Court stated that a violation of Article 163 of the CO does not automatically constitute an incompatibility with public policy within the meaning of Article 190(2)(e) of PILA (see also *Decision 4A_508/2017*, discussed in *Legal update, Swiss Supreme Court dismisses ultra petita argument and affirms approach to challenges to contractual penalties based on public policy*). In any case, the court noted that the case in question did not concern the reinforcement of an unlawful or immoral undertaking, but a case of impossibility of performance. The Supreme Court considered that Article 163(2) of the CO precisely declares that parties are permitted to agree on contractual penalties even where performance has become impossible. Therefore, the Supreme Court found that there had not been a violation of Article 163 or of public policy and rejected A's application to set aside the arbitral tribunal's orders related to the penalty payments.

Comment

This case presented the Swiss Supreme Court with the rare opportunity to rule on an *extra petita* application with regard to two such applications. The case also led to the even rarer occurrence of a partial setting aside of an arbitral award.

Interestingly, both parties filed applications for setting aside based on the grounds of *extra petita* and both parties partially prevailed. The reason for the setting aside was essentially the same for both parties' applications, namely the absence of an express claim for performance (that is, for payment) by A.

The Supreme Court's decision serves as a reminder that arbitrators are prohibited from "correcting" the parties' prayers for relief. A tribunal may be tempted to do so if it is unclear why a party requested "only" declaratory relief instead of payment, or where the absence of a payment claim even seems nonsensical. However, it is up to the parties and their counsel alone to decide what the tribunal should rule on. Experienced arbitrators might want to raise the content of the prayers with the parties in order to make sure that they have understood their meaning but, at the end of the day, they have to keep to the prayers for relief submitted. At the same time, parties' counsel should invest sufficient time and care when drafting the prayers for relief, since this not only has an important impact in terms of res judicata but, also, as this decision vividly demonstrates, on the content of the award.

With regard to the Supreme Court's considerations related to public policy, it is interesting to note that the court does not appear to generally exclude Article 163 of the CO as a basis for a public policy challenge. The court's position is in line with Decision 4A_508/2017, where the Supreme Court found that although the possibility of reducing penalties under Article 163(3) of the CO is a mandatory part of Swiss domestic law, it is not part of international public policy. The court, therefore, did not review the amount of the awarded penalties. However, the Supreme Court held that contractual penalties could violate public policy if they were to result in excessive restrictions on the debtor's economic freedom (see *Legal update, Swiss Supreme Court dismisses ultra petita argument and affirms approach to challenges to contractual penalties based on public policy*).

This latest rejection of a substantive public policy argument upholds the status quo whereby to date, only one challenge on the ground of substantive public policy has succeeded on the merits (see decision 138 III 322, discussed in *Legal update, Landmark ruling of Swiss Supreme Court setting aside CAS award for violation of substantive public policy*).

Case

Decision 4A_294/2019 (13 November 2019).

END OF DOCUMENT

Related Content

Topics

Arbitral Awards and Challenges
ICC
Institutional and Ad hoc Arbitration

Legal update: case report

Swiss Supreme Court dismisses ultra petita argument and affirms approach to challenges to contractual penalties based on public policy • Published on 19-Mar-2018

Legal update: archive

Landmark ruling of Swiss Supreme Court setting aside CAS award for violation of substantive public policy • Published on 02-May-2012

