Supreme Court – DAB proceedings precondition for arbitration under FIDIC Conditions

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Introduction

In a decision dated July 7 2014 (4A_124/2014)(1) the Federal Supreme Court analysed whether dispute adjudication board (DAB) proceedings are a precondition that must be met before resorting to arbitration under Clause 20 of the International Federation of Consulting Engineers (FIDIC) Conditions of Contract. The court analysed the issue in the context of a challenge of a partial award in which the arbitral tribunal found that it had jurisdiction to hear a case under Clause 20 despite the fact that no DAB proceedings had taken place. While the court disagreed with the arbitral tribunal's finding that DAB proceedings are not a prerequisite for the initiation of arbitration under Clause 20, it recognised that there are exceptions to this requirement which were applicable in the context of this case, and rejected the challenge.

Facts

According to the facts set out in the court's redacted judgment, the case concerned a dispute arising from a contract between a French road contractor and a state-owned company in charge of the construction of a highway in an unnamed country (the owner). The contract incorporated the 1999 FIDIC Conditions of Contract (the court did not specify which book), and in particular provided in Clause 20 for an *ad hoc* DAB. In 2011 the contractor notified the owner of its intention to refer a dispute to the DAB under Clause 20, and, in a laborious process which lasted several months, the parties tried to set up the DAB. Three members were eventually appointed, but a dispute adjudication agreement was never executed. Ultimately, in 2013 the contractor initiated arbitration under the Rules of the International Chamber of Commerce. The owner challenged the arbitral tribunal's jurisdiction, arguing that before arbitration could be initiated, the DAB proceedings must be completed.

The arbitral tribunal issued a partial award on the issue, with the majority of its members finding that DAB proceedings are not a prerequisite for the right of a party to resort to arbitration, and therefore that it had jurisdiction despite the fact that the dispute had not been previously submitted to or decided by the DAB. According to the court's summary of the partial award, the arbitral tribunal's reasoning focused on the wording of the sub-clauses of Clause 20.

The tribunal considered in particular that the term 'shall' in Clause 20.2 ("[d]isputes shall be adjudicated by a DAB in accordance with Sub-clause 20.4") should be read not in isolation, but in the context of the rest of Clause 20. The use of the term 'may' in Sub-clause 20.4 ("either Party may refer the dispute in writing to the DAB"), which the tribunal considered to amount to a *lex specialis* in relation to Clause 20.2, notably suggested to it that DAB proceedings are optional.

It found further support for its position in the exception set out in Clause 20.8, which provides that a dispute may be referred directly to arbitration if, once a dispute has arisen, "there is no DAB in place, whether by reason of expiry of the DAB's appointment or otherwise". According to the arbitral tribunal (which relied on the recent English High Court judgment in *Doosan Babcock* v *Comercializadora de Equipos y Materiales Mabe* ([2013] EWHC 3010/TCC)), this exception applies even where a DAB has never been put in place. This was the case here, given that the parties had not signed a dispute adjudication agreement. The arbitral tribunal also noted in an *obiter* statement that the contract did not specify a time limit for constitution of the DAB, suggesting that the DAB procedure was intended to be optional.

Decision

The owner sought to set aside the partial award before the Supreme Court (which has exclusive jurisdiction to hear annulment requests for all international arbitration proceedings in Switzerland), on the grounds that the arbitral tribunal lacked jurisdiction. Alternatively, the owner requested that the

arbitration be suspended pending the outcome of the DAB proceedings. However, the court rejected the request, as it disagreed with large parts of the arbitral tribunal's reasoning - in particular, its interpretation of the wording of Clause 20. According to the court, the wording of the provision suggests that DAB proceedings are a mandatory prerequisite for arbitration.

Application of Swiss law on interpretation

The court conducted its interpretation of Clause 20 as a whole under Swiss law – the law of the seat of the arbitration – which it considered to be applicable pursuant to Article 178 of the Swiss Private International Law Act. While Article 178 defines the law applicable to arbitration agreements, the court considered that provisions dealing with pre-arbitral procedures should be interpreted under the same law as the arbitration agreement, as to do otherwise would be artificial and unnecessarily complicated. The court therefore recalled the basic approach to the interpretation of contracts under Swiss law – namely, to look beyond the literal meaning of the contract to seek to establish the parties' real and common intention. If no such real and common intention can be established, a court or tribunal will look to how the contract could and should have been understood in good faith by a reasonable third party, in light of all relevant circumstances. The court further noted that even though the FIDIC conditions are standard form contracts, it must interpret them in an individualised manner in light of the circumstances of each case, and therefore cannot take a strictly objective approach.

Interpretation of Clause 20

In interpreting the various sub-clauses of Clause 20, the court focused largely on the wording, although it read the provisions as a whole and took into account their purpose.

In particular, the court considered that the use of the term 'shall' in Clause 20.2 indicates that submitting a dispute to the DAB is a requirement rather than an option. Contrary to the arbitral tribunal's reasoning, the court found that Clause 20.4, which uses the term 'may', does not constitute a *lex specialis* in relation to Clause 20.2 and does not suggest that DAB proceedings are optional. Rather, the use of the term 'may' simply means that it is open to either party to initiate DAB proceedings.

The court further disagreed with the arbitral tribunal's broad interpretation of the exception in Clause 20.8, under which a party would be free to resort to arbitration if, for whatever reason, no DAB is in place at the time a dispute arises. According to the court, such an approach would make the dispute resolution mechanism under Clause 20 an empty shell, in particular in cases in which the contract provides for an *ad hoc* DAB, which by definition would be constituted only after a dispute had arisen. The court also distinguished the *Doosan* case relied on by the arbitral tribunal, as it dealt with a failure to constitute a standing DAB within a contractual time limit - a situation which falls under the scope of the exception in Clause 20.8.

The court also rejected the arbitral tribunal's *obiter* statement that the absence of a contractual time limit for the constitution of the DAB suggests that the procedure was intended to be optional, even though the court considered the absence of such a time limit to be a flaw. In particular, it found that the Swiss precedent on which the arbitral tribunal had relied (4A_18/2007, June 6 2007) did not support the arbitral tribunal's reasoning on this point, as it dealt with a multi-tiered arbitration clause contemplating mediation and conciliation which was drafted in more permissive language.

Exceptions to requirement to submit a dispute to DAB

While the court found that the submission of a dispute to a DAB was a precondition to arbitration, it accepted that there are exceptions to the requirement to submit a dispute to a DAB, arising notably under Clause 20.8 and the general principle of good faith. According to the court, a party may in particular circumstances – which would have to be assessed on a case-by-case basis – be prevented from invoking a failure to submit a dispute to a DAB in order to object to arbitration proceedings.

The court found that such circumstances existed on the facts of this case. It recalled that the *raison d'être* for the introduction of the DAB in the FIDIC conditions was to facilitate the efficient resolution of disputes arising during construction works, in a manner that would not jeopardise the works. However, in the case before it, the constitution of the *ad hoc* DAB had begun after completion of the works, at a time when the parties' positions were already irreconcilable. It was therefore unlikely that DAB proceedings would prevent the dispute from subsequently being submitted to arbitration. Moreover, the DAB was not operational even though 15 months had passed since the contractor's referral – a period five times longer than the 84-day period contemplated in the FIDIC conditions for the DAB to render its decision – and the owner had dragged its feet in the process of constituting the DAB. Finally, the court found that the parties' failure to sign the dispute adjudication agreement required by Clause 20.2 meant that the DAB was not "in place" within the meaning of the exception set out in Clause 20.8.

Under the circumstances, the court considered that the contractor could not be blamed for having lost patience and initiated arbitration. It therefore concluded that the fact that no DAB proceedings were initiated was not fatal to the arbitral tribunal's jurisdiction.

Comment

The decision is a rare example of a state court reviewing the interpretation of the FIDIC conditions by an arbitral tribunal. Given the wide use of the FIDIC conditions, especially in Eastern Europe, Russia, Africa and the Middle East, this is an important decision for construction practitioners. In light of the prevalence of the choice of Swiss law as the applicable law in international construction contracts, it will have an impact well beyond Switzerland's borders.

The approach to the interpretation of standard form contracts adopted by the court was consistent with the general approach to the interpretation of contracts under Swiss law. While the court placed a great deal of weight on the wording of the FIDIC conditions, it also looked more broadly at their purpose and emphasised that they must be interpreted in an individualised manner which takes into account the specific circumstances of each case.

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Endnotes

(1) For an English translation of the decision see www.swissarbitrationdecisions.com.