When Should an Arbitral Tribunal Sitting in Switzerland Confronted with Parallel Litigation Abroad Stay the Arbitration?

[Editor's note]. A recent judgment of the Swiss Supreme Court (the Federal Tribunal) setting aside an arbitral award for having been rendered in a dispute already pending abroad (in Panama) has attracted considerable attention.[1] A number of practitioners, many of them currently involved in arbitration proceedings in Switzerland, have turned to the Editors for advice on the proper scope of this decision and the conclusion to draw from it. Just as any other reader of the decision, the Editors are of course not privy to the Federal Tribunal's deliberations and motivation and can obviously offer no guidance with respect to the Federal Tribunal's *own* estimation as to the consequences of its decision. They can, however, attempt to interpret the decision in light of general principles of international arbitration as applied in Switzerland and as enforced by the Federal Tribunal in its capacity as sole appeal body for all challenges to arbitral awards rendered in Switzerland.

Many arbitrators seem to fear that the Fomento Decision somehow obliges them to stay arbitration proceedings in every case of prior litigation abroad and, in case the foreign judge rules that it has jurisdiction, defer to its decision. It is submitted that this is *not* the rationale of the case. Rather, Fomento is an "arrêt d'espèce", one of a kind. The Federal Tribunal could but set aside what seems to have been an ill-reasoned award based on very particular circumstances.

I. Summary of the Procedure in Fomento de Construcciones y Contratas S.A. (FCC) v. Colon Container Terminal S.A. (CCT)

In 1996, CCT and FCC entered into a contract whereby FCC was to provide civil engineering services for the construction of a port in Panama.

[1] Decision of 14 May 2001, Fomento de Construcciones y Contratas S.A. (Spain) v. Colon Container Terminal S.A. (Panama), Official Court Reporter 127 III 279. Published in the original French language (p. 544) and in an English translation (p. 555) in this issue of the ASA Bulletin. See also the comments in this Bulletin by J.M. VULLIEMIN, Litispendance et compétence internationale indirecte du juge étranger, page 439 and M. LIATOWITSCH, Die Anwendung der Litispendenzregeln von Art. 9 IPRG durch schweizerische Schiedsgerichte : ein Paradoxon ?, page 422. An English case abstract by Laurent LEVY/Elliott GEISINGER/David RONEY will be published in International Arbitration Law Review 2001.

The contract was based on the FIDIC conditions. A dispute arose between the parties and FCC filed a court action against CCT in Panama. CCT challenged the jurisdiction of the court, on the basis of an arbitration agreement in the contract which provided for arbitration in Geneva, Switzerland. The court of first instance rejected the challenge as late. CCT appealed this decision and filed a Request for Arbitration, without waiting for the decision on appeal. While the arbitration proceeded, the court of appeal in Panama considered the challenge to be timely and annulled the first instance decision. This time, FCC appealed to the Supreme Court of Panama. The arbitral tribunal did not wait for the outcome of the appeal but ruled in an interim award of 30 November 2000 that it had jurisdiction. It stated that the concept of *lis pendens* does not apply in the relation between courts and arbitral tribunals and that neither the applicable rules governing the arbitration proceedings nor the law applicable to the merits did provide for a mandatory stay.

On 22 January 2001, the Supreme Court of Panama quashed the decision of the Court of appeal. It found that CCT had not timely raised the arbitration defense. In Switzerland, FCC challenged the interim arbitral award before the Swiss Federal Tribunal on the ground that the arbitrators had no jurisdiction and had disregarded the principle of lis pendens. The Federal Tribunal admitted the challenge.

II. The Federal Tribunal's Findings on the Application of Lis Pendens Principles to Arbitration

1. Lis pendens principles apply to arbitration

The question whether Article 9 of Switzerland's PIL Act[2], which embodies the lis pendens rule, applies in the relation between courts and arbitration had not been decided so far by the Federal Tribunal, and had been left open in a recent case (Buenaventura, 124 III 83[3]). Legal authorities were split on the issue. Some commentators considered that lis pendens can only

[2] Article 9 PIL Act . Lis pendens. "*When an action having the same subject matter is already pending between the same parties in a foreign country, the Swiss court shall stay the case if it is to be expected that the foreign court will, within a reasonable time, render a decision capable of being enforced in Switzerland*" (Translation by BUCHER / TSCHANZ, Private International Law and Arbitration, Basic Documents, Basel 1996)

[3] ASA Bull., 1998, 365.

exist in the relation between two courts or two arbitral tribunals. The Federal Tribunal now settled the matter. It decided that the principles set out in Article 9 PIL Act *do* apply to arbitration.

2. The failure to apply the lis pendens principles is contrary to public policy and may result in the annulment of the award

The Federal Tribunal stated that the lis pendens rule is part of public policy. If the requirements of Article 9 PIL Act are met, an arbitral tribunal sitting in Switzerland *must* stay the arbitration. An award that does not apply these rules can be set aside.

3. A contrario: If the lis pendens requirements of Article 9 PIL Act are *not* met, an arbitral tribunal sitting in Switzerland is not bound to stay the arbitration (but can do so, if the interest of the arbitration so command)

The Federal Tribunal did not set aside an award merely because a foreign action was pending before the arbitration was initiated in Switzerland. Not every prior court proceeding is relevant under Article 9 PIL Act. The latter provision specifies that, in addition to having been filed *before* the Swiss proceedings,

- *the actions must have the same subject matter and be between the same parties ;*
- *it can be expected that the foreign court will render a decision within a reasonable time ;*
- *that decision is capable of being enforced in Switzerland.*

In the award challenged before the Federal Tribunal, the arbitrators had not applied the rule of Article 9 PIL Act. It was this failure to consider the very principle of lis pendens which required the award's annulment. In other words, since the Fomento decision is one of a *non*-application rather than of a *wrong* application of Article 9 PIL Act, it cannot serve as a precedent for the *key issue: what decisions are capable of being enforced in Switzerland*. The Federal Tribunal has in fact stated in its recent decision in Buenaventura[4] that

[4] ASA Bull. 1998, 365.

a judgment rendered by a foreign (in casu: Peruvian) court in proceedings initiated before an arbitration filed in Switzerland is not enforceable in Switzerland if the foreign court would have been bound under the New York Convention to admit the existence of an arbitration agreement and, hence, to refer the parties to arbitration. In Fomento, the Federal Tribunal again pointed to the issue of the validity of the arbitration agreement. If such an agreement existed, the courts of Panama lacked jurisdiction, and their decision was not capable of being enforced in Switzerland. Hence, the enforceability requirement of Article 9 PIL Act would not have been met, and there would be no need to stay the arbitration.

III. After Fomento - How Should An Arbitral Tribunal Sitting in Switzerland Determine What Is the Requirement of Article 9 PIL Act Concerning the Enforceability of the Foreign Decision ("Anerkennungsprognose")?

Surprisingly, the Fomento decision, on its face, seems to defer to Panama law for the crucial issue of the validity of the arbitration agreement. It holds, indeed, that Panama law shall govern the issue of whether a party has – by proceeding in a foreign court - waived its right to invoke the arbitration agreement in an arbitration in Switzerland. On a closer look, however, it becomes evident that the Federal Tribunal has not set out to thwart the intention of the Swiss legislator but has confirmed the latter's wish to hold an arbitration agreement to the liberal Swiss standards.

The Federal Tribunal in Fomento does not examine whether there was a (valid) agreement to arbitrate. Rather, it acknowledges that the parties are free to *replace* such an agreement by a subsequent agreement providing for a different dispute resolution method and/or a different forum. Such a subsequent agreement can occur tacitly if the conduct of a party permits the conclusion in light of the principle of good faith ("principe de la confiance", "Vertrauensprinzip") which permeates Swiss law, that the party wanted to waive its right to arbitrate. The fact that FCC seized the courts of Panama is, in the eyes of the Federal Tribunal, an offer to waive the right to rely on the arbitration clause. The decisive question, therefore, is whether, by proceeding on the merits before the Panama Court, CCT has accepted that offer. It should be stressed that the reasoning of the Federal Tribunal up to this point is based

exclusively on *Swiss law*. On the other hand, whether the conduct of CCT in the Panama proceedings constitutes a decision to proceed on the merits is a question, which according to the Federal Tribunal, must be decided by the (foreign) lex fori, the law of Panama. In truth, it is submitted that the Federal Tribunal did not defer to that lex fori as a rule but *only because Swiss law* (based on the principle of good faith), in the particular circumstances of the case, *called for such deference*.

Indeed a rather singular aspect of the Fomento case seems to have been decisive for the Federal Tribunal: It frequently happens that a local party, in the face of an arbitration agreement, ignores it and seizes "its" local courts, hoping that the latter will be more favorable to its views than an arbitral tribunal abroad. In Fomento, it was the other way around: CCT, that is the *local* party, preferred to arbitrate, whereas FCC, the *foreign* contractor, preferred the local courts. Under these circumstances it was perfectly legitimate to consider that the manner in which CCT's conduct was interpreted under local law should be relevant for an arbitral tribunal in Switzerland examining the validity of the arbitration agreement, even if the latter has to apply Swiss arbitration law. Indeed, according to the Federal Tribunal "*One can expect of a large company, represented by local counsel, that it complies with local procedural rules if it intends to rely on the arbitration agreement and to challenge the jurisdiction of the courts*."

There is another holding of the Fomento decision which in the opinion of the undersigned clearly shows that, in the Federal Tribunal's view, for an arbitral tribunal sitting in Switzerland the ultimate decision on the validity of an arbitration agreement must be made in accordance with Swiss law alone:

"The risk that a foreign court, hostile to arbitration, may interfere with the arbitration does not need to be considered in the present case. In fact, the judgment of that court would not be enforceable in Switzerland. The principle of res judicata and of lis pendens, however, apply only to foreign judgments which are capable of being recognized in Switzerland"

In fact, the principle of good faith, the "Vertrauensprinzip" also leads us to consider another issue: The duty of arbitrators sitting in Switzerland to protect any party which has signed a valid arbitration agreement from the interference of hostile courts. If the parties consented to arbitrate their

disputes in Switzerland, they wanted to avoid *any* interference of *any* foreign court to the extent that the Swiss law protects them from such interference. The agreement contains a positive choice – arbitration in Switzerland according to Swiss international arbitration rules – and a negative choice – exclusion of all courts, Swiss courts included. Arguably, the exclusion aims primarily at interference of the courts in the country which would normally (in the absence of a forum selection or arbitration clause) have jurisdiction, especially in countries where the judiciary is not independent and/or familiar with handling complex international disputes. Swiss arbitration law is committed to fully protecting the parties' agreement. It is for this reason, among others, that it is a popular place for arbitration. It would be a betrayal of the trust of the parties and of this commitment were arbitrators in Switzerland obliged to defer to foreign laws to determine the validity of an arbitration agreement providing for arbitration in Switzerland.[5]

Chapter 12 of the PIL Act embodies an autonomous set of rules for international arbitration in Switzerland. Thus, Article 177 and 178 PIL Act govern the form and scope of any arbitration agreement. They refer to foreign law only to the extent that the latter is more favorable. For instance, a party cannot argue that, according to another law, the dispute is not arbitrable. Neither can a State or state-owned entity assert that it has immunity or could otherwise not arbitrate according to its own law. It is the spirit of the Swiss arbitration law, the clear intent of the authors of the 1987 PIL Act, to give the widest possible application to a freely agreed arbitration clause providing for arbitration in Switzerland. No foreign court or law should be allowed to interfere with a party's attempt to enforce the arbitration agreement. Moreover, the Federal Tribunal admits that, by this liberal approach the Swiss legislator was aware and accepted the risk that Swiss awards may not be enforceable in certain less liberal jurisdictions (Fincantieri, 118 II 353[6]).

Finally, were the Swiss courts to give precedence to a foreign law to decide on the validity of an arbitration agreement providing for a place of arbitration in Switzerland, forum running to for a (courts) which the parties wanted to exclude would be encouraged.

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[5] See also F. Perret, Parallel Actions Pending Before An Arbitral Tribunal and a State Court : The Solution under Swiss Law, in Arbitral Tribunals or State Courts – Who must defer to whom ? ASA Special Series No. 15, p. 65, 75.

[6] ASA Bull, 1993,58,67.

IV. Conclusions

This is the first time that the Federal Tribunal has clearly stated that the lis pendens rule of Article 9 PIL Act applies to arbitral tribunals and courts alike. The decision obliges arbitral tribunals sitting in Switzerland to give *due* consideration to a litigation initiated abroad prior to the arbitration. Whether the procedural rules which govern the arbitration provide for a stay of the arbitration is irrelevant. In order to consider what *is* due the arbitral tribunal must examine whether there is a lis pendens event as defined by Article 9 PIL Act. In other words, the arbitral tribunal in Switzerland must verify: (i) that there is a prior litigation before a foreign court between the same parties and on the same subject matter, (ii) that this court will render a decision within a reasonable time, and (iii) that the decision will be enforceable in Switzerland.

For this last point, the arbitral tribunal will have to assess whether the arbitration agreement upon which the claimant relies is valid based *exclusively* on Swiss arbitration law. If there *is* a valid arbitration agreement, a prerequisite for a stay is not met: the enforceability of the foreign court decision.

If the arbitral tribunal comes to the conclusion that there is a valid arbitration agreement under Swiss arbitration law, it should proceed with the arbitration, unless the tribunal decides based on in its discretion and common sense that compelling practical reasons require it to stay the arbitration.

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