

Court proceedings in violation of an arbitration agreement: Arbitral Jurisdiction to issue anti-suit injunction and award damages for breach of the arbitration agreement

Matthias Scherer

(mscherer@jalive.ch)

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1. Damages for breach of an arbitration agreement

A 2010 decision of the Swiss Federal Supreme Court that has received surprisingly little scholarly attention has touched upon an issue of considerable practical relevance: What remedies are available to a party if it is sued by the other party before a state court in breach of an arbitration agreement between them. In its judgment *4A_444/2009* of February 11, 2010, the Supreme Court ruled on an application to set aside a Swiss arbitral award brought by a former distributor of a Swiss pharmaceutical company “N”. The underlying facts were the following (the arbitral award is not published but its salient features are reported in the Court’s judgment):

In 2005, N terminated a distribution agreement with its Israeli distributor and licensee. Subsequently, N initiated arbitration in Switzerland under the Swiss Rules of International Arbitration claiming for the payment of ordered and/or supplied goods in the amount of 13 million Swiss Francs as well as of a contractual penalty. N further sought declaratory relief in respect of the distributor’s claim for compensation of the goodwill which it allegedly had created in Israel for N’s products in the many years it had distributed them in the country. It requested that the tribunal find that the claim was without merit and that the distributor could therefore not set it off against N’s payment claim.

In September 2006, the distributor sued N in the district court of Tel Aviv/Jaffa, advancing the same claim for the payment of an indemnity for the goodwill which it had allegedly created in Israel for N’s products. N

objected to the jurisdiction of the Israeli courts and sought a stay of the proceedings pending resolution of the identical claim in the arbitration. The Tel Aviv court rejected the objection, and assumed jurisdiction.

N then applied to the arbitral tribunal claiming damages of 100,000 Swiss Francs for breach of the arbitration agreement. N subsequently amended its prayer for relief to reflect the fact that the court proceedings in Israel were still pending. In it, N sought declaratory relief that the domestic proceedings constituted a breach of the arbitration agreement and triggered the distributor’s duty to pay damages to N.

The distributor objected to the jurisdiction of the arbitral tribunal over N’s requests for declaratory relief with respect to the distributor’s set off claim regarding the goodwill it had allegedly created, and over N’s claims regarding the distributor’s alleged violation of the arbitration agreement by the initiation of court proceedings in Israel.

In a Partial and Interim Award on November 19, 2008, the arbitral tribunal confirmed that it had jurisdiction *inter alia* over N’s claims regarding the alleged breach of the arbitration agreement. The distributor did not challenge this award. In a second award of August 3, 2009, the arbitral tribunal confirmed its previous ruling on jurisdiction with respect to N’s new claim for declaratory relief, and held as follows:

“16.3 Respondent has breached the Arbitration Clause contained in the Distribution Agreement 2004 by filing its claim for goodwill in Israel on 20 September 2006 and Respondent is liable to Claimant for damages (if any) incurred as a result of this breach, provided that Claimant, in later arbitral proceedings, establishes the remaining elements of its claim under Article 97 of the Swiss Code of Obligations.”

The distributor applied to the Swiss Federal Supreme Court to have the second award set aside for lack of arbitral jurisdiction under art.190(2)(b) PIL Act. The Supreme Court has exclusive jurisdiction to deal with any such application pursuant to art.190 PIL Act.

The Court ruled that the application was inadmissible on a procedural ground. The distributor should have challenged the first award which affirmed the arbitral tribunal’s jurisdiction. Since it failed to do so, the distributor could not challenge the second award on jurisdictional grounds. The second award had merely confirmed a ruling already contained in the second award. The confirmation was required in the arbitral tribunal’s view because of N’s amended prayer for relief—in which it shifted from claiming damages to seeking a declaration that the initiation of a court action violated the arbitration agreement—having formally been accepted by the arbitral tribunal only after the issuance of the first award. The arbitral tribunal had however already dealt with the modified prayer in its first award. The Court judgment is

not very clear on this point, but it appears that the distributor argued that the first award could not possibly be deemed to have addressed a prayer for relief which it had not yet formally accepted.¹

In any event, the Supreme Court went on to find that even if the distributor could have challenged the second award for lack of jurisdiction, such a challenge would fail on the merits.

First, the distributor argued before the Supreme Court that an arbitral tribunal did not have jurisdiction to decide on the jurisdiction of a State court or to interfere with a cost decision made in proceedings before a State court. It further posited that the arbitral tribunal was not entitled to penalise a party for having brought a claim before a State court, in particular since the State court in question had ruled that it had jurisdiction to hear the claim.

The Supreme Court rejected this line of argument. The arbitral tribunal had not ruled on the jurisdiction of the Israeli courts or their cost decision. Rather the arbitral tribunal had examined its jurisdiction regarding a claim that a specific provision in the contract under which the arbitration was brought, namely the arbitration agreement, had been breached. In order to successfully argue that the arbitral tribunal had no jurisdiction to decide this point, the distributor should have demonstrated that a claim for breach of the contractual arbitration agreement was not subject to that very agreement. The distributor confused this question with a distinct question, namely whether the arbitral tribunal had jurisdiction to deal with its claim for compensation of goodwill.

As to the argument that the arbitral tribunal could not penalise the distributor for seizing the Israeli courts, the Court found that this was a question pertaining to the merits of the arbitration. The Supreme Court cannot review arbitral awards on the merits, save for violations of public policy. No such violation was shown.

Second, the distributor argued that the award was incompatible with public policy (art.190(2)(e) PIL Act) as it restricted the constitutionally guaranteed right of access to a court. The Supreme Court ruled that this right (art.30 of the Swiss Constitution; Art.6(1) ECHR) did not prevent the parties from agreeing to submit their disputes to arbitration, which they had precisely done in the instant case.²

The distributor also asserted that the arbitral tribunal had violated public policy by improperly granting declaratory relief. Under Swiss law, this type of relief is only available if the applicant has an interest in the declaration that deserves protection. Such an interest is usually found not to exist if the applicant could make a claim for payment rather than merely seeking a declaration. The Supreme Court found that if Swiss law applied, it determined under what circumstances a party

can obtain a declaration as to the existence or inexistence of a claim governed by Swiss law. The Court added, however, that neither the Swiss rules on the availability of declaratory relief nor the question of what rules applied to declaratory relief in international arbitration pertained to public policy.³

In addition, the distributor complained that the arbitral tribunal had applied Swiss law (as the law chosen by the parties) instead of Israeli law to the question of whether N had violated trade mark rights of the distributor. The Supreme Court gave short shrift to this argument. Indeed, the Court is not entitled to review whether an arbitral tribunal has correctly applied the law or not, and the question of whether a choice of law also applies to alleged trade mark violations does not reach public policy threshold. In any event, the distributor had not shown that the award was incompatible, in its result, with public policy.⁴

2. Anti-suit injunctions

N did not seek to obtain an anti-suit injunction when its opponent seized the Israeli court, even though the arbitral tribunal may well have granted such an injunction. It is indeed well established that arbitral tribunals sitting in Switzerland have the power to order a party to refrain from pursuing legal action in certain circumstances.⁵ In a similar case which also arose under a distribution agreement, such an injunction was sought by one of the parties and granted by the ICC tribunal hearing the case.

The facts of the case are as follows:

Company “A” concluded a distribution agreement with distributor “B”, incorporated in Morocco. The agreement which provided for ICC arbitration in Geneva covered the distribution of company “A”’s goods by distributor “B” in Libya. Thereafter, “B” started a business relationship with company “C” in Libya with a view to the implementation of the distribution agreement. “A” had objected to this relationship. “C” was not a party to the distribution agreement (and was therefore also not a party to the arbitration agreement).

A dispute arose out of the purported invalid termination of the distribution agreement by “A”. “A” initiated ICC arbitration against “B” in Geneva, seeking a declaration that the distribution agreement had been validly terminated.

Shortly before commencing the arbitration, the claimant “A” had been informed that the distributor “B” and “C” had initiated court proceedings in Libya against “A” and against one of its subsidiaries, the company “D”. The claims were based on the distribution agreement.

¹ Judgment 4A_444/2009 of February 11, 2010 at [4.1.2], to be reported in *ASA Bulletin* 2011. An English translation will be published in *Swiss International Arbitration Law Reports* 2010.

² In addition, the argument that the Swiss constitution guarantees access to a foreign court seems flawed.

³ Judgment 4A_444/2009 of February 11, 2010 at [4.2.1] cited above.

⁴ Judgment 4A_444/2009 of February 11, 2010 at [5] cited above.

⁵ For case law see Matthias Scherer & Werner Jahnel, “Anti-suit and anti-arbitration injunctions in international arbitration: A Swiss perspective” (2009) 12(4) *Int. A.L.R.*, 66–73.

Together with its request for arbitration, the claimant “A” filed an application for urgent interim relief, requesting that the arbitral tribunal order the respondent “B” “to withdraw and to refrain from pursuing the proceedings it has initiated against [“A”] before the courts of Libya.”

Shortly after the arbitration was initiated, “A” learnt that “B” had also filed a court action against both it and “D” in Morocco. “A” therefore asked the arbitral tribunal to order “B” to also withdraw from these proceedings.

“B” requested that “A”’s application be dismissed, arguing *inter alia* that the parties in the arbitration proceedings and in the court proceedings before the Libyan courts were not identical and that not all parties to the State court proceedings were bound by the arbitration clause. Even if “B” withdrew from the proceedings, they would continue with “C” as the claimant. “B” also argued that the claims were not covered by the arbitration agreement. Moreover, “B” took the view that “A” had appeared in the court proceedings and could therefore not ask “B” to withdraw its claim. In both court proceedings, “A” had participated in order to object to the jurisdiction of the State courts by invoking the arbitration agreement contained in the distribution agreement. Finally, according to “B”, the relief requested from the arbitral tribunal was not “conservative or interim” within the meaning of article 23 of the ICC Rules, as a withdrawal from pending State court proceedings would preclude it from reopening them and would therefore entail a final waiver of its rights.

The arbitral tribunal granted the requested relief. The tribunal first considered that both court proceedings were ultimately based on the distribution agreement and were therefore within the scope of the arbitration agreement. Moreover, the arbitral tribunal decided that it had the jurisdiction and power to decide on the requested interim relief under art.23.1 of the ICC Rules. Finally the tribunal decided that the relief was appropriate, necessary and urgent:

“The jurisdiction and the powers of the Arbitral Tribunal are of course limited to the matters that the parties have submitted to its jurisdiction. In this case, to order any measure related to the pending Court proceedings in [...], it is required that the claims pending before those Courts arise out of or in connection to the Distributorship Agreement, which is a fact that has been established.

[...]

[I]t is unnecessary to wait for the [...] Courts to rule on their jurisdiction to hear the claims pending before them, as this Arbitral Tribunal has jurisdiction to decide on its own jurisdiction, which none of the parties has contested.

According to art. 23.1 ICC Rules, the Arbitral Tribunal has the power to issue any measures that “it deems appropriate”.

[...]

It is clear that a withdrawal without prejudice [...] can be deemed to be “conservative” and “interim”. [...]. Whereas a withdrawal with prejudice could *prima facie* be deemed to be more problematic, this issue does not arise in this case.” [...] First, because the Claimant is not asking Respondent to forfeit any rights, but to resort to arbitration. [...] And second, [...] it remains to be seen whether the effects of a withdrawal [...] with prejudice [...] could extend to the arbitration, so as to entail a definitive disposition of Respondent’s rights. For instance, the affected party could eventually file a counterclaim in the arbitration if it were still allowed by the ICC Rules, such as for instance art. 19 ICC Rules.

[...]

[t]he fact that the proceedings may have been also initiated by parties that are not bound by the arbitration clause [...] and Claimant would have appeared anyway [...] does not change the conclusion that Respondent is bound by the arbitration agreement and can only bring claims against Claimant in arbitration proceedings if Claimant requests so. It is precisely this interest that is protected through the requested measure.

[..]

The measure is also necessary as the proceedings [before the state courts] involve claims related to the Distributorship agreement and [...] there is a real risk that [...] Claimant shall be obliged to assume additional significant costs and expenses [...] as well as time-consuming evidence-taking [...] there is also a risk of contradictory decisions.

[..]

The measure is also urgent. If it is not adopted now, Claimant will be forced to incur [...] additional expenses and costs. The fact that the proceedings pending before state Courts are still at the early stages [weighs] heavily for the Arbitral Tribunal.”

Conclusion

Arbitral tribunals sitting in Switzerland have jurisdiction to deal with claims for damages for breach of the arbitration agreement. If the breach consists in a party’s participation in or commencement of court proceedings that are incompatible with that party’s obligation to submit disputes to the contractually agreed arbitral tribunal, the arbitral tribunal can issue interim orders enjoining a party from pursuing such court proceedings. While the arbitral tribunal has no “imperium” to enforce such an order itself, a party will usually think twice before it risks antagonising the tribunal by pursuing court proceedings. In addition, the arbitral tribunal might issue an interim order obliging the party in breach of the arbitration agreement to secure the likely damage caused to the other party by the breach. Such an order can take the form of an award, and be enforceable under the New York Convention, or other instruments applicable in the country where enforcement is sought.

An injunction enjoining a party from pursuing court proceedings must be justified. In most cases, it will be required that the State court proceedings at issue are initiated in violation of the party's obligations under the arbitration agreement. An injunction will in most cases be warranted if the requesting party can show that the proceedings it seeks to enjoin on the basis of a valid arbitration agreement are identical to those pending before the arbitral tribunal. It is however conceivable that parallel proceedings would be found to be improper even if they do not deal with the merits of the case, but only with certain aspects of it. Finally, the mere fact that the court proceedings involve third parties that are not parties to the arbitration agreement would not prevent a tribunal from enjoining the party which is bound by the agreement from pursuing the proceedings.

Not all court proceedings related to a dispute that is subject to an arbitration agreement are incompatible with the latter. Interim measures for protection are usually not

considered to be in breach of the arbitration agreement (but can be, for instance, if they would prejudice the very dispute submitted to arbitration).

The traditional prerequisites for interim measures, such as urgency and irreparable harm, although sometimes applied by arbitral tribunals, do not seem well-suited to cases of alleged violations of an arbitration agreement.

The breach of the arbitration agreement does not necessarily have to occur prior or during the arbitration. It is also conceivable that the breach occurs after the arbitration proceedings are completed. For instance, in one recent case, a party that had lost an ICC arbitration sought to claw back what it has been ordered to pay by the arbitral tribunal through court actions in its home country, asserting an allegedly different legal defense than in the arbitration and extending its claim also to third parties which were not involved in the arbitration proceedings. Parties faced with such court actions could raise the defenses of *res judicata* and *estoppel*, as well as allege a breach of the arbitration agreement and initiate a new arbitration in the neutral arbitration forum.