Memorandum

of	Peter Straub
re	**Setting aside of awards: Breaches of public policy in Switzerland**
Date	30 October 2013 PST / DKE

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1. Introduction: The Five Grounds of Art. 190 para. 2 PILS

1 The basics for an annulment of an international arbitral award in Switzerland are regulated in Art. 190 para. 2 of the Swiss Federal Private International Law Statute (PILS).[1] **Five grounds** are enumerated for the setting aside procedure. An award may only be annulled:

a. If the sole arbitrator was not properly appointed or if the arbitral tribunal was not properly constituted;

b. If the arbitral tribunal wrongly accepted or declined jurisdiction;

c. If the arbitral tribunal's decision went beyond the claims submitted to it, or failed to decide one of the items of the claim;

d. If the principle of equal treatment of the parties or the right of the parties to be heard was violated;

e. If the award is incompatible with public policy.

2. Overview: Statistical Analysis of Setting Aside Proceedings in Switzerland

2 From 1989 to 2009, the Swiss Federal Supreme Court ("FSC") dealt with 289 decisions regarding setting aside of awards.[2] At average, the Court disposed of challenges with increasing efficiency, typically four months. Out of the 289 decisions, almost 80% (229 decisions) were decided on the merits. Approximately a 10 % were dismissed either due to withdrawal (29 decisions) or lack of admissibility (31 decisions). However, only 6.5–7% (15 challenges) were found to be successful, a number which often is called "the magic seven".[3]

3 As might be expected, not all of the five grounds enumerated in Art. 190 para. 2 PILS are equally popular. Lit. d, the principle of equal treatment of the parties or the right to be heard, was most often invoked (144 decisions), followed by lit. e, **the public policy clause (142 out of 289 decisions).** However, it has to be

1 English translation of the PILS: http://www.umbricht.ch/de/frameset7.html.

2 See the statistical analysis in FELIX DASSER, International Arbitration and Setting Aside Proceedings in Switzerland – An Updated Statistical Analysis, ASA Bulletin 28, 1/2010, 83 et seq.

3 DASSER, op. cit., 84 et seq.

mentioned, that the public policy clause is mostly not invoked by itself, but together with one or several of the other four grounds of Art. 190 para. 2 PILS, a fact which has also been called a "public policy side show"[4].

4 The public policy clause was even increasingly invoked in the years 2006–2009 (38 decisions). If one looks only at these years, the public policy clause **became the most popular ground for a challenge**. And even though there exist no statistics yet which cover the years after 2009, a quick look at the years from 2009 to 2013 shows that this trend is continuing to grow. Between 2010 and 2013, more than 50 decisions dealing with the public policy clause can be found.[5]

5 However, the public policy clause kept a "famously clean record" until 2010[6]: Out of all the challenges, there resulted **nil** annulments of awards due to public policy. Only in 2010, the FSC delivered a truly historical decision because for the first time since PILS came into force in 1989, the FSC **set aside an international arbitral award for a violation of (procedural) public policy**.[7] In 2012, the FSC **set aside a second award due to a breach of (substantive) public policy** in a landmark decision.[8]

6 This low rate of successful public policy challenges to this date is probably also influenced by the fact that the public policy clause is mostly invoked together with other grounds; and the statistics show that, the more grounds there are invoked, the less successful decisions result.[9]

3. Basics and Function of the Public Policy Clause

7 The grounds for the breaches of public policy in Switzerland are regulated in Art. 190 para. 2 lit. e PILS. The provision is very short: An award can be challenged, if the award is incompatible with Swiss public policy ("ordre public"). It is a mere clause of incoherency; it only has a defensive function (so called *negative public policy*).[10]

4 DASSER, op. cit., 88.
5 http://www.swissarbitrationdecisions.com/decisions?search=public%20policy&f[0]=field_judge_keywords%3A685.
6 DASSER, op. cit., 87.
7 DFC 136 III 345; see also http://www.swissarbitrationdecisions.com/setting-aside-of-award-for-violation-of-public-policy-principle-?search=public+policy.
8 DFC 138 III 322.
9 DASSER, op. cit., 89.
10 GIRSBERGER/HEINI/KELLER/KREN KOSTKIEWICZ/SIEHR/VISCHER/VOLKEN, Zurich Commentary of the Swiss Federal Code on Private International Law, Art. 190 No. 39.

8 Throughout the years, the FSC has developed a profound case law elaborating the terms of public policy and ordre public. According to this case law, an award is incompatible with public policy when it violates **"fundamental legal principles "** and therefore is **incompatible with Swiss law and values**.[11]

9 **Two differentiations** are important regarding the handling of the public policy clause in the case law of the Swiss Federal Supreme Court:

- the question of **national and international public policy**, and
- the differentiation between **substantive and procedural public policy**.

4. National and International Public Policy

10 In the beginning, the FSC left open the question if the term "public policy" only means Swiss public policy or whether also a foreign, a supranational or even a universal set of values resp. legal principles recognized by Switzerland and the International Community of States are embraced.[12]

11 However, in following decisions, the FSC held that the question should be approached pragmatically.[13]

12 **Starting point** should always be the Swiss legal order, but this should not exclude taking into account foreign, supranational and universal "ordre public" in **certain cases**.[14] In particular where foreign law is applicable to the merits purely Swiss considerations must recede into the background.[15] But in any event – and irrespective of the applicable *lex causae* – the fundamental principles of law recognised by Switzerland and the International Community of States must be respected.[16]

11 Decision of the Swiss Federal Supreme Court, DFC 117 II 604, 606 f. See also e.g. WALTER/BOSCH/BRÖNNIMANN, International Arbitration in Switzerland, p. 225 et seq.

12 DFC 117 II 604, 606, No. 3. See also BERTI/SCHNYDER, Art. 190, No. 72, in: HONSELL/VOGT/SCHNYDER (eds.), International Arbitration in Switzerland, An Introduction to and a Commentary on Articles 176-194 of the Swiss Private International Law Statute.

13 DFC 120 II 155, 168, No. 6.

14 DFE 126 III 249, 253, No. 3b; DFC 128 III 194, No. 4a; DFC 132 III 389, E. 2.2.2

15 BERTI/SCHNYDER, op. Cit., Art. 190, No. 72. See WALTER/BOSCH/BRÖNNIMANN, op. cit., p. 229 et seq.

16 DFC 120 II 167 et seq.

13 The FSC has also held that in total, *both* the national as well as the international public policy which are taken into account are considered to be *Swiss* public policy under Art. 190 para. 2 lit. e PILS.[17]

5. Substantive and Procedural Public Policy

14 There are two main categories of breaches of public policy in the case law of the FSC: (i) the breaches of **substantive** public policy and (ii) the breaches of **procedural** public policy.

15 For both categories it is important to know that the public policy test does not presuppose that the facts of the case in point have a particular connection to Switzerland.[18] In Swiss arbitration proceedings, no distinction should be made based on whether domestic or foreign parties are involved. There is already a certain connection with Switzerland trough the fact that the arbitration has its seat in Switzerland is thus subject to the Swiss *lex arbitri*.[19]

5.1. Breaches of Substantive Public Policy

16 In general, the FSC has held that the substantive public policy clause should be constructed **narrowly** and that only **core legal principles** should be a ground for the annulment of awards.[20]

17 Thus, even clear violations of law and manifestly false findings of fact are not in themselves sufficient to constitute a violation of public policy.[21] Also, a decision made for considerations of equity instead of by application of the law chosen by the parties does not violate public policy *"at least in cases where the result does not fundamentally differ from that which would have been reached had the chosen law been applied, so that the deviation is compatible with public policy"*[22].

17 See e.g. WALTER/BOSCH/BRÖNNIMANN, op. cit., p. 229.

18 HONSELL/VOGT/SCHNYDER/BERTI (eds.), Basle Commentary of International Private Law, Art. 190,No 71; BERTI/SCHNYDER, op.cit., Art. 190 N. 76.

19 LALIVE/POUDRET/REYMOND, Le droit de l'arbitrage interne et international en Suisse, Art. 190, 428.

20 DFC 117 II 604, 606, No. 3; HONSELL/VOGT/SCHNYDER/BERTI (eds.), Basle Commentary of International Private Law, Art. 190, No. 71.

21 DFC 116 II 634.

22 DFC 116 II 637.

18 To the **group of core principles** of substantive public policy established by the FSC belong, i.a., the principle of

- *pacta sunt servanda*,
- the principle of good faith,
- the prohibition of abuse of rights,
- the prohibition of discrimination,
- the prohibition of expropriation without compensation and
- the protection of the incapacitated.[23]

19 Along with this group of core principles, the promise of bribe payment[24] is considered to be a breach of public policy as well as a true accusation of involvement of money laundering of the counter party which would not be scrutinized adequately by an arbitration court.[25]

20 The principle of **pacta sunt servanda** is one of the principles mostly dealt with before the FSC. However, this principle is not considered to be violated merely by the fact that the arbitration tribunal constructs a contract in a particular manner. Neither is it a violation of public policy to rule that a contract is invalid. The principle is however violated if an arbitral tribunal denies the existence of a contract against its better judgment although it should be perfectly aware that under the applicable law there is a contractual claim.[26]

21 The Swiss Federal Supreme Court has also **denied specific principles** to be part of the list of core principles of substantive public policy. Not considered to be part of public policy are e.g. the limitation of private-law claims, the regulation of compensation and national/international competition law.[27]

23 DFC 117 II 604, 606, No. 3; DFC 116 II 636.
24 DFC 119 II 380, 384 f., No. 4a.
25 DFC 4P.208/2004.
26 BERTI/SCHNYDER, op. cit., Art. 190, No. 74.
27 HONSELL/VOGT/SCHNYDER/BERTI, op. cit., Art. 190, No 73 a; DFC 4P.278/2005, No. 3.

22 In the **landmark case** of 27 March 2010, the FSC has for the first time set aside an award due to a breach of substantive public policy.[28]

23 The case involved the **Fédération Internationale de Football Association (FIFA) and a Brazilian player Matuzalem**. The player entered into an employment contract with the Ukrainian football club Shakhtar Donetsk in 2004. He terminated the contract without notice in July 2007, going to Real Saragossa, a Spanish club, which undertook to hold him harmless of any possible damage that could arise from the premature termination of the contract he had with Shakhtar Donetsk. FIFA ordered the payment of compensation. An appeal was made to the Court of Arbitration for Sport ("CAS") and in an award of 19 May 2009, the CAS increased the compensation to be paid to Shakhtar Donetsk to € 11'858'934 with interest at 5% from July 2007.

24 A civil law appeal was filed with the FSC, which was rejected on 2 June 2010. In July 2010, the Disciplinary Committee of FIFA opened disciplinary proceedings because Shakhtar Donetsk had not been paid. Real Saragossa advised the Disciplinary Committee of FIFA that it was practically insolvent and would probably go bankrupt, whereupon both Matuzalem and Real Saragossa were found guilty of breaching their obligations under the CAS award of 19 May 2009. Among other consequences, this could result in being automatically banned from any activity in connection with football pursuant to the applicable FIFA regulations. The decision of the FIFA Disciplinary Committee of 31 August 2010 was again appealed to the CAS and a three arbitrators Panel rejected the appeal in an award of 29 June 2011, which became the object of the new proceedings in front of the FSC.

25 The FSC decision is famous, stating that banning a professional player for an undetermined time worldwide as he could not pay a large amount of damages awarded to his former club was a breach of substantive public policy in itself.[29]

5.2. Breaches of Procedural Public Policy

26 Fundamental procedural deficiencies which do not fall under lit. a–d. of Art. 190 para. 2 PILS can be considered as breaches of public policy. The FSC ac-

28 DFC 138 III 322.

29 See for a summary of the case http://www.swissarbitrationdecisions.com/landmark-decision-of-the-swiss-supreme-court-international-arbit?search=public+policy.

knowledges breaches of public policy in cases of violations of "**fundamental and generally acknowledged procedural principles**", if the violations of such **contradict the sense of justice in an intolerable way**.[30]

27 Some cases stand out of the decisions dealing with procedural public policy.

28 The FSC has held for example that it is not *per se* sufficient for a breach of procedural public policy that the arbitrational code of procedure has been applied wrongly or indiscriminately.[31] The FSC has also denied breaches of public policy in the case of an inner contradiction in the operative part of an award.[32]

29 So far, the Court has left open the question if the missing reasoning of an award can be considered *per se* a breach of public policy.[33]

30 In the **landmark decision** of 13 April 2010 between the **Spanish football club Atlético de Madrid SAD and the Portuguese football club Sport Lisboa E Benfica – Futebol SAD** (and under the participation of the Fédération Internationale de Football Association, FIFA), the Court has acknowledged – after leaving open the question for years – a breach of the procedural public policy by the arbitration Court in a case where the arbitration court had not taken into account the ***res iudicata*** of an earlier judgment.[34]

31 In this landmark case, Sport Lisboa E Benfica, a well-known Portuguese football club, and Club Atlético de Madrid SAD, an equally well known Spanish football club, had a dispute with regard to compensation for a player who had been trained by Benfica and eventually went to play for Atlético.

32 In 2001, Benfica claimed compensation on the basis of the 1997 FIFA Regulations for the Status and Transfer of Players. The FIFA Special Committee awarded compensation in April 2002, but the Zurich Commercial Court overturned the decision, essentially holding in a judgment of 21 June 2004 that the corresponding provision in the FIFA Regulations was void on Swiss and European competition grounds. The judgment of the Zurich Commercial Court was not appealed to the FSC and therefore entered into force.

30 DFC 126 III 249, 253, No. 3a. See also LALIVE/POUDRET/REYMOND, op. cit., Art. 190 No. 6.
31 DFC 126 III 249, 253, No. 3a.
32 DFC 128 III 191, 197, No. 6.
33 DFC 116 II 375.
34 DFC 136 III 345, 347, No. 2.1.

33 A new claim was brought by Benfica in 2004. The FIFA Special Committee rejected it in 2008 and an appeal was made to the Court of Arbitration for Sport (CAS). On 31 August 2009, the CAS awarded compensation in an amount of EUR 400,000 notwithstanding the 2004 judgment of the Zurich Commercial Court. Club Atlético de Madrid successfully appealed to the FSC.[35]

6. Other Matters of Public Policy

34 Besides breaches of substantive and procedural public policy, the FSC has also dealt with several other matters under Art. 190 para. 2 lit. e PILS.

6.1. Foreign Mandatory Rules

35 Arbitral tribunals are competent to decide whether and to what extent **mandatory public law rules of the applicable law or of other countries** must be applied. Here, the question comes up whether the application, the non-application or the wrongful application of the foreign mandatory public law rule of the applicable law or of other states by an arbitration court can be challenged as a violation of public policy.[36]

36 At the adjudication stage it might well be appropriate that an arbitral tribunal take foreign mandatory norms into consideration. It is, however, another question whether this should be taken into account at the appeal's stage in the context of alleged public policy violation.

37 The case law of the FSC hitherto raises doubts whether the FSC would be prepared to examine the contents of such an award. It can hardly be expected that, e.g., foreign import and export regulations, market regulations, competition law and the like could be found to form part of those fundamental principles of law which constitute public policy.[37]

35 See for a summary of the case http://www.swissarbitrationdecisions.com/setting-aside-of-award-for-violation-of-public-policy-principle-?search=public+policy.

36 BERTI/SCHNYDER, op. cit., Art. 190, No. 78.

37 BERTI/SCHNYDER, op. cit., Art. 190, No. 79.

6.2. Special Reservation Clauses

38 Another topic in connection with public policy is the meaning of **special reservation clauses** for the arbitrational procedure. Can an arbitral tribunal with seat in Switzerland award punitive or multiple damages if the applicable law provides so? And if so, are those awards potentially in breach of public policy?

39 However, to this date and according to the opinion of most Swiss legal writers, such arbitral awards would not violate the core principles defined by the Swiss Federal Supreme Court belonging to public policy.[38]

7. Conclusion

40 The public policy clause has grown to be the most popular of the five grounds for the challenge of an award in the last seven years in Switzerland. 142 out of 289 decisions before the Swiss Federal Court dealt with public policy until 2009, and the last four years confirm this trend.

41 However, the clause kept a "famously clean record" until 2010: Zero annulments of awards have resulted out of the reasoning of public policy before the FSC. And since 2010, the FSC has only set aside two awards due to breaches of public policy. Thus, the Swiss view is, for practical purposes, that it is irrelevant how public policy is defined "because there will be no annulment anyway"[39].

42 Nevertheless and in the light of the decisions since 2010, the meaning of the public policy clause must be highlighted. The FSC has developed a profound case law regarding substantive and procedural standards which should be considered to be national, international or universal "ordre public". Whilst the FSC has held that the public policy clause should be construed narrowly in general, it has also established a list of principles which have to be regarded as a core of public policy[40]. Given this increasing role of the public policy clause before the FSC, the developed standards could play a more decisive role in the future setting aside proceedings than in the past.

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38 BERTI/SCHNYDER, op. cit., Art. 190, No. 81; HONSELL/VOGT/SCHNYDER/BERTI (eds.), op. cit., Art. 190, No 78 et seq.
39 DASSER, op. cit., 87.
40 Such as pacta sunt servanda, the principle of good faith or the prohibition of discrimination.