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Iura Novit Arbitrator: Application of the Law on the Tribunal's Own Motion

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The Swiss Federal Tribunal confirmed that the legal analysis of an arbitral tribunal in Switzerland is not restricted by the legal arguments of the parties. Rather, by applying the principle of «iura novit arbitrator» the Swiss Federal Tribunal considers that a tribunal does not already surprise the parties, if it merely chooses to apply the law in a different manner than the parties anticipated.

I. Background

[1] In the time between November 2014 and May 2015, the Swiss company C initiated three arbitration cases at the Swiss Chambers' Arbitration Institution SCAI against the French company R (consid. B.a).

[2] All three cases related to a Swiss law governed Share Purchase Agreement (SPA), entered into by the Parties in September 2011. Under the SPA, R had purchased the shares in the French company T from C for EUR 1 and a flexible earn-out to be calculated in accordance with an earn-out plan defined in the SPA. With its Notices of Arbitration, C requested R's payment of an earn-out in excess of EUR 4 Mio. for the years 2012 to 2014 (consid. A).

[3] Subsequently, all three cases were joined by SCAI. In line with the arbitration agreement, an arbitral tribunal composed of three arbitrators was constituted, with seat of the arbitration in Zurich (consid B.a).

[4] C based its claim on the earn-out plan in Article 2.2.2 (b) and annex 2.2.2(b) of the SPA (see consid. A for a reproduction of the relevant parts).

[5] R rejected C's claim in full, arguing that no earn-out was owed to C pursuant to the agreed earn-out plan.

[6] In the proceedings on the merits, the correct method for the calculation of the earn-out and its application were at the heart of the dispute (see consid. B.b for a summary of the Parties' diverging positions on the calculation method and the numerous points at issue in this respect).

[7] On 23 December 2016, the Arbitral Tribunal issued its Final Award, partially granting C's claim and ordering R to pay to C some EUR 3 Mio. as earn-out.

[8] With its appeal dated 1 February 2017, R requested the Swiss Federal Tribunal to set aside the award.

II. Decision

[9] As a basis of its appeal, R invoked Articles 190(2)(d) and (e) of the Swiss Private International Law Act ([PILA](#)), arguing that R's right to be heard had been violated and that the award was incompatible with public policy, respectively.

A. Right to be heard

1. General Considerations

[10] With regard to the purported violation of R's right to be heard, R submitted that the Arbitral Tribunal in its award on the one hand had failed to consider several defence arguments raised by R, and, on the other hand, had based its decision on unforeseeable and surprising considerations (consid. 3).

[11] At the outset of its analysis, the Swiss Federal Tribunal recalled its long-standing case law on the right to be heard in adversarial proceedings (consid. 3.1): The Swiss Federal Tribunal noted that the right to be heard, as guaranteed by Articles 182(3) and 190(2)(d) of the Swiss Private International Law Act, does not require an international arbitral award to be motivated. Yet, a minimum duty exists, obliging an arbitral tribunal to consider and deal with the relevant issues. This duty is violated when, inadvertently or as a result of a misunderstanding, an arbitral tribunal does not take into consideration allegations, arguments, evidence and offers of evidence submitted by one of the parties and relevant for the award to be rendered.

[12] In line with the Swiss Federal Tribunal's case law, it is incumbent upon the allegedly aggrieved party to demonstrate, in its appeal against the award, how an oversight of the arbitrators prevented it from being heard on an important issue. It is for the party to establish, on the one hand, that the arbitral tribunal did not consider some of the factual, evidentiary or legal elements that the party had consistently advanced in support of its arguments and, on the other hand, that those factors were such as to affect the fate of the dispute (consid. 3.1, with reference to [DFT 142 III 360](#), consid 4.1.1 and 4.1.3).

[13] According to the Swiss Federal Tribunal, the right to be heard in adversarial proceedings is far from being unlimited in Switzerland. On the contrary, in the field of international arbitration, significant restrictions apply: A party is not entitled to comment on the legal assessment of the facts or, more generally, on the legal argument to be used, unless the arbitral tribunal intends to base its decision on a rule or a legal ground which has not been mentioned in the proceedings, which none of the parties in the case had availed of, and relevance of which could not be foreseen in the case at issue. An arbitral tribunal is also not required to give special notice to a party of the decisive character of a factual element on which it is about to base its decision, insofar as the factual element has been alleged and proved in accordance with the applicable laws and rules. Finally, an appeal invoking a violation of the right to be heard must not be used as a basis to provoke an examination of the application of the substantive law (consid 3.1).

2. Failure to consider certain defence arguments

[14] Under the first subhead (alleged failure to consider certain defence arguments raised by R), R asserted that the Arbitral Tribunal had failed to consider in its award R's argument that, in cases of doubt, the SPA should be interpreted in accordance with the rule *in dubio contra proferentem* (also known as *in dubio contra stipulatorem*) and, therefore, in favour of R as the party that apparently had not drafted the terms of the earn-out plan (consid. 3.2.1). According to R, the used term «Cost

Cap» was, therefore, to be construed strictly, rather than broadly, as suggested by C (consid. 3.2.1).

[15] Analysing the considerations of the Arbitral Tribunal, the Swiss Federal Tribunal noted in its decision that the Arbitral Tribunal had interpreted the SPA in line with the principle of trust («*Vertrauensprinzip*») and, therefore, in accordance with the applicable Swiss law. Referring to its case law on the subsidiary nature of the rule *in dubio contra stipulatorem*, the Swiss Federal Tribunal concluded that there was no room for the application of such rule in the present case, and held that R's right to be heard had not been violated in this respect (consid. 3.2.1).

[16] Under the first subhead (alleged failure to consider certain defence arguments raised by R), R also asserted that the Arbitral Tribunal had failed to consider in its award R's argument that C had previously accepted that no earn-out was owed for the years 2012 and 2013 (consid. 3.2.2).

[17] Analysing the argument raised by R, the Swiss Federal Tribunal in essence found that the argument was so far from being conclusively raised that the Arbitral Tribunal was right to implicitly dismiss the argument (without expressly addressing it; consid. 3.2.2, in fine).

3. Unforeseeable and surprising reasoning

[18] Under the second subhead (allegedly unforeseeable and surprising reasoning), R found fault with the Arbitral Tribunal's allegedly unforeseeable and surprising method for the calculation of the earn-out in the award, without giving the Parties sufficient opportunity to comment on the effects of this decision (consid. 3.3.1).

[19] In particular, C and R both (exclusively) pleaded extreme positions on the calculation issue: C argued that due to a specific reason, no deductions were justified when calculating the earn-out amount, at all. R responded that the specific reason alleged by C was without merit and, therefore, all the deductions were justified (consid. 3.3.1).

[20] The Arbitral Tribunal, after having extensively questioned R's witness on each allegedly deductible item during the hearing, analysed each deductible item in the award. It only found some of them to be justified. The Arbitral Tribunal considered that the requirements of some of these items were not sufficiently demonstrated by R (consid. 3.3.1 et seq.).

[21] R argued against this background that the use of a calculation method which no party had pleaded was surprising *per se* and in particular also because it infringed the burden of proof rules of Swiss law (consid. 3.3.1).

[22] The Swiss Federal Tribunal noted that the principle of *iura novit curia* applied to arbitral tribunals with seat in Switzerland (consid. 3.3.2). It considered that the parties had thus an onus to «*envisage all imaginable scenarios*» of a potential decision and to «*develop their arguments as a consequence*» (consid. 3.3.2) including subsidiary submissions, if necessary.

[23] Analysing the procedure chosen by the Arbitral Tribunal in detail, the Swiss Federal Tribunal in essence found that it was not «*clear how the fact that the Arbitral Tribunal had recalculated the amount of the earn-out for the three relevant years [...] was likely to surprise the appellant, since the object of the dispute was to determine the amount of any earn-out due by the acquirer of the shares*» (consid. 3.3.2).

B. Public policy (pacta sunt servanda)

[24] Regarding the purported violation of the *pacta sunt servanda* principle, R asserted that the Arbitral Tribunal had applied its interpretation of the term «costs» in an inconsistent and contradicting manner to different items of the earn-out calculation in its award (consid. 4.2).

[25] The analysis of the Swiss Federal Tribunal started with a summary of its case law on the scope and meaning of *pacta sunt servanda* as a matter of public policy (consid. 4.1): In the context of Article 190 (2)(e) of the Swiss Private International Law Act, *pacta sunt servanda* is violated only if

the arbitral tribunal fails to apply a contractual term although it considers the parties to be bound by it or, conversely, applies a contractual term although it considers the parties not to be bound by it. As repeatedly pointed out by the Swiss Federal Tribunal, contract interpretation itself is not part of *pacta sunt servanda*. This is why almost all disputes invoking a breach of contract as the cause of action cannot be challenged on the grounds of a *pacta sunt servanda* violation (consid. 4.1, with reference to Judgement of the Swiss Federal Tribunal [4A_318/2017](#) of 28 August 2017, consid. 4.2).

[26] Referring to the response statement of the Arbitral Tribunal to R's appeal, the Swiss Federal Tribunal found that the assumption of an inconsistent interpretation of the contract was not only without basis, but also totally unrelated («*totalemt étranger*») to the meaning of *pacta sunt servanda* as a matter of public policy (consid. 4.2).

C. Ruling

[27] Based on its analysis, the Swiss Federal Tribunal dismissed R's appeal as meritless.

III. Comments

[28] The present decision is instructive on the scope and the meaning of the principle *iura novit curia* which applies to arbitral tribunals with seat in Switzerland (see also [DTF 130 III 35](#), consid. 5; also referred to as *iura novit arbiter*).

[29] Arbitrators who sit in Switzerland are not seen as (mere) decision-makers with respect to the individual arguments pleaded and responded to between the parties in the legal briefs.

[30] Rather, Swiss arbitrators have the right (and probably also the duty) to apply the applicable substantive law correctly to the established facts of the case on their own motion. This applies even if the parties failed to plead the correct application of the law, to the extent that the decision is not surprising (Judgement of the Swiss Federal Tribunal [4A_374/2011](#) of 1 September 2011, consid. 2.4).

[31] The parties are expected to know this principle and, consequently, anticipate and argue on all potential outcomes of a case, if necessary in the form of subsidiary positions.

[32] For an unduly surprising decision it is not sufficient that an arbitral tribunal adopts a legal position that was not pleaded by either party. Only if the arbitral tribunal e.g. applies a legal act to which no party has ever referred in the legal briefs, an unduly surprising element would have to be accepted ([DTF 130 III 35](#), consid. 5).

[33] The Swiss notion of *iura novit arbiter* in arbitration proceedings is not self-evident for all our international colleagues (and not so for those from common law jurisdictions in particular).

[34] The following considerations may thus be of practical use for Swiss arbitrations:

- i. *As party representative in Swiss arbitral proceedings*: It is not sufficient to rebut the (legal) arguments of the counterparty. Rather, the parties are expected to anticipate and address as subsidiary positions further reasonable applications of the law by the arbitral tribunal. For this exercise, professional legal advice on the substantive law at issue appears to be indispensable.
- ii. *As arbitrator with seat of the arbitration in Switzerland*: Even if the Parties plead the law and its application in detail, the arbitrators are expected to apply Swiss law correctly on their own motion. If the tribunal's own application of the law is expected to considerably deviate from the positions of both parties, it is advisable to gently «warn» the parties in an appropriate manner: either by examining witnesses on facts which point to the anticipated application of the law (as in the present case, see above, para. 20). Or by sending the Parties a list of questions at an appropriate stage in the proceedings which give indications on the potential application of the law.
- iii. *For institutions administering Swiss arbitration cases*: If a tribunal applies a concept of law that

was not pleaded by either party, this is not (necessarily) inaccurate. Nevertheless, any tribunal will be grateful for a brief hint in such situations, in order to avoid any oversights.

[35] Finally, on another note, the Swiss Federal Tribunal made positive reference to a response statement of the Arbitral Tribunal in the setting aside proceedings (consid. 4.2).

[36] It appears that the Swiss Federal Tribunal is indeed interested in response statements of arbitral tribunals and considers them as helpful.

[37] In view of this development, it may more and more become best practice for arbitral tribunals to submit a brief response statement in Swiss setting aside proceedings to assist the Swiss Federal Tribunal in the finding of accurate and adequate decisions.

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