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Annulment of Swiss International Arbitration Awards for Incompatibility with Substantive Public Policy: First Annulment in over Twenty Years

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Commentary

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Introduction

Finality of international arbitration awards is often invoked by users as foremost among their reasons for choosing international arbitration. This limits the time and costs of obtaining an enforceable determination of one's rights. But the price of finality is that procedural abuses may be tolerated, and factually and legally inaccurate awards may be left undisturbed, and enforced.

International arbitration systems around the world therefore present compromises between these two competing goals. Swiss international arbitration for its part comes down decidedly on the side of finality. Under Swiss law, there is very little opportunity to challenge an international arbitration award rendered in Switzerland in regard to procedural complaints, and, it was thought, practically none in regard to substantive outcomes.

In a judgment of 27 March 2012¹, however, for the first time in over twenty years the Swiss Supreme Court has set aside an international arbitration award on the basis of a violation of substantive public policy. While one swallow does not a summer make, this case signals that there is at least some practical possibility of substantive control of international arbitration awards rendered in Switzerland, and it suggests the nature of any further development of the law in this area.

Finality of International Arbitration Awards under Swiss Law

The promulgation of the modern Swiss international arbitration law on 1 January 1989 in Chapter 12 of the Swiss Federal *Private International Law Act* (the "**PIL Act**") marked a break with the past in a number of significant ways. Prominent among them was a powerful concern for the finality of international arbitration awards. By virtue of Art. 176(1) of the PIL Act, international arbitration awards are those resulting from an arbitration seated in Switzerland where at least one of the parties had neither its domicile nor its place of habitual residence in Switzerland at the time the arbitration clause was entered into.

Finality of international arbitration awards is assured in Switzerland first by the requirement in Art. 191 of the PIL Act that any challenge be finally decided by a single instance of court review. The default position at the time the PIL Act entered into force was that that single instance was the Swiss Supreme Court. Now, under Art. 389(1) of the Swiss Civil Procedure Code, which entered into force on 1 January 2011, the single review instance *can only be* the Swiss Supreme Court. Moreover, by Art. 192(1) of the PIL Act, if none of the parties is Swiss, the parties may expressly exclude all challenges against the award.

Secondly, finality is ensured by there being a short, exhaustive list of bases for challenge. These are set out in Art. 190 of the PIL Act. The last of the five bases is that the award is "incompatible with public policy". It is the only basis upon which one can challenge the substance of the award.

Public Policy Review of Swiss International Arbitration Awards

The law in Switzerland on most aspects of public policy review of international arbitration awards has been long settled, and many of its essential features have on repeated occasion been recited by the Supreme Court in its decisions. The Court will only strike down arbitration awards or parts of arbitration awards; it will not substitute its own view of the substantive question, nor will it provide direct instructions to any arbitral tribunal before which the question may come. An award is contrary to public policy when “it does not take account of fundamental legal principles and therefore is inconsistent with the important, widely-recognised value ordering.”² It is only the result of the award which the Court looks to in assessing compatibility with public policy.³ Its reasons are not material for these purposes. The cases where an arbitration award will fail for incompatibility with public policy can be expected to be “exceedingly rare.”⁴

There was a question until recently as to the point of view from which to determine what the legal principles were the violation of which amounted to a violation of public policy, whether Swiss or some other point of view.⁵ In a 2006 decision the Supreme Court finally determined that the relevant point of view was an international one, but that nonetheless it was the Swiss view of international values which was to apply.⁶ The Court reasoned that the public policy ground of review of arbitration awards did not aim at protecting any particular State’s interests, and those of Switzerland in particular, and therefore its content should be international. Nonetheless, the Court accepted that the understanding of fundamental principles is not uniform around the world. The Court therefore held that it is the view of the Swiss legislator as to what values are fundamental which is to be followed. Naturally then, the material perspective of international fundamental values is a Swiss one.

Both before this identification of the character of the fundamental values which are protected by public policy review and after, the Swiss Supreme Court repeatedly invoked the same examples: the bindingness of contracts, the prohibition on abuse of legal rights, the principle of good faith, the prohibition upon expropriation without compensation, the prohibition against

discrimination, and the protection of civilly incapacitated persons.⁷

This is a curious litany of instances of public policy principles. To begin, the Court did not develop it in the crucible of cases raising facts engaging these principles, but rather it produced this list in the abstract. Moreover, these principles have on the whole a distinctly private and private law character, which seems incongruous for a concept bearing the epithet “public”. While it is true that a particularly grievous private injury may attract public concern, it would doubtless be more in line with expectations that the values behind “public policy” be characteristically public ones, such as fundamental social, political and even economic values. The latter would seem more likely to be candidates, in the Supreme Court’s own words, as “the cardinal principles respect for which every State – ideally – must ensure [. . .]”.⁸

Nonetheless, the Supreme Court has been clear that this list of public policy values is not exhaustive.⁹ On occasion, the Supreme Court has listed other values, even those of a more public nature, such as anti-corruption¹⁰ and the prohibition of forced labor, as being among those protected by public policy review of arbitration awards.¹¹

On the other hand, famously, in the 2006 decision the Supreme Court held that competition law (on the facts there EU and Italian competition law, but one may understand any competition law) is not public policy material. The Court found so since, in its view, competition law is not held to be of sufficient importance widely enough around the world, and there is not sufficient substantive convergence globally, for it to be raised to the dignity of public policy status.¹²

Both of these propositions are eminently doubtful, but the test leaves open the prospect of public policy recognition of competition law at a later stage when more States accept its importance and agree on the fundamental features it must have. It is perhaps because of this that competition law is the first area of vital political, social or economic norms of a State to which the Supreme Court has concretely applied its public policy analysis. The Supreme Court seeks cautiously to lay down its approach to public policy step by step, and with competition law in its present state, as the Supreme Court understood it, the Supreme Court can float its principles

without committing itself irreversibly. In that very case the Supreme Court candidly acknowledged that it has patiently been building the public policy edifice for fifteen years, “groping no doubt, but always following the same guiding principle.”¹³

Perhaps the Court's focus on private and private law values can be seen in this same light. The Court is wary of grasping the nettle of pronouncing upon important public norms, especially where other States are concerned.

The First Annulment Decision on a Substantive Basis

Yet a truly significant step forward is the transition from talking about substantive public policy requirements, and their application to annulling an award. The Supreme Court finally took that step on 27 March 2012 when it annulled a sports arbitration award for its contravention of the right to exercise an economic activity.

On the facts, a professional soccer player, the Brazilian Francelino da Silva Matuzalem, had been in previous proceedings found liable jointly and severally with the soccer club Real Saragoza to pay a Ukrainian club, FC Shakhtar Donetsk, almost EUR12,000,000 along with interest. Both soccer teams were members of what is effectively the world governing body of soccer, FIFA, a Swiss association. The liability arose in that Matuzalem's move from FC Shakhtar Donetsk to Real Saragoza in 2007 was found to be in violation of Rule 13 (“Respect of Contract”) of the FIFA *Regulations on the Status and Transfer of Players* then in force. Rule 13 provided then (as it does now), “[a] contract between a Professional and a club may only be terminated on expiry of the term of the contract or by mutual consent.” Neither the exception to Rule 13 in Rule 14 (“Termination for Just Cause”) nor that in Rule 15 (“Termination for Just Sporting Cause”) was satisfied.

Although Matuzalem was careful to obtain an indemnity from Real Saragoza at the time of this blatant breach of Rule 13, Real Saragoza subsequently become insolvent, and was therefore not able to pay. When Matuzalem himself failed to pay the damages, the Secretary of the FIFA Disciplinary Commission initiated proceedings against both Real Saragoza and Matuzalem under Art. 64 of the FIFA *Disciplinary Code* then in force. Among other disciplinary measures, the FIFA

Disciplinary Commission decided that if the damages in full were not paid within 90 days, upon a request from FC Shakhtar Donetsk then Matuzalem would be banned from every activity relating to football. An arbitral tribunal sitting in Lausanne, Switzerland under the auspices of the Court of Arbitration for Sport confirmed this decision in an arbitration award.

In the challenge to this arbitration award, with reference to the Swiss Constitution (Art. 10) the Swiss Supreme Court first recognised that a person's right to personal development (“*Persönlichkeit des Menschen*”) is a fundamental legal good which is deserving of legal protection. The Court then observed that the right to free personal development is protected by fundamental rights to economic freedom, in particular the freedom of choice of profession and free access to private economic activity. As the Supreme Court noted, these latter rights find expression in Art. 27 of the Swiss Civil Code (“CC”) where they are directed not against government action but against restrictions ensuing from relations with private actors. The Court then affirmed that these rights in Art. 27 CC met the test for eligibility as public policy values – they belong to the legal principles forming the essential, widely-recognised value ordering which, from the Swiss point of view, must constitute the foundation of all legal orders.

The Swiss Supreme Court then proceeded to identify the content of this economic freedom under Art. 27 CC, citing in particular that it is a violation of this provision for such rights to be exposed to the whim of another, and to restrict economic freedom to such a degree that a person's economic existence is threatened. The Court then proceeded to assess whether this right was restricted by FIFA's threatened exclusion of Metuzalem from football, and if so, whether this might be justified in the circumstances.

The Court determined that the FIFA exclusion measure was in fact in restriction of the right since FIFA was the authoritative organisation for football and the exclusion would be effective. The Court then found that the exclusion seeking to enforce the damages penalty was not justified, for three reasons. First, it was not suited to the achievement of its stated purposes since if Metuzalem was excluded from playing football this would result in his not earning money to pay the damages award. Secondly, the measure was not necessary, since the 1958 New York Convention made enforcement of the

arbitration award imposing damages effective, and Metuzalem was living in a NY Convention State, Italy. Thirdly, the Court found that the abstract object of enforcing an arbitration award was not as weighty in the balance as the concrete, unlimited restriction on engaging in football-related activities.

By consequence the Supreme Court held that the unlimited professional exclusion was in violation of public policy, within the meaning of Art. 190(2) PIL Act and therefore annulled the offending orders in the arbitration award.

Significance of the Decision

The first thing to be noticed is that the right to personal development is a distinctly Swiss concept. Eugen Bucher, the author of one of the principal commentaries on Article 27 CC called the article “a discovery” of the father of the Swiss Civil Code, Eugen Huber. This fact tends to suggest that the public policy analysis is not as international as the Supreme Court would have it to be.

A grievous violation of Article 27 CC is an appropriate place for the Supreme Court to start in annulling an arbitration award for substantive reasons. The right is economic in nature, but a violation of it entails such an extreme restriction of it that human dignity is assailed. In Switzerland, under Art. 177(1) PIL the general principle is that everything economic is arbitrable. Thus the substantive violation in the award has the effect of reinforcing the purpose of Art. 177(1) PIL, and is at all events coherent with its vision of leaving the widest powers to the arbitral tribunal.

The principal question following this judgment is what broader principles does it establish which may affect future cases? In this judgment the Supreme Court has answered the criticism that its substantive review under Art. 190(2)(e) PIL is a dead letter, while keeping to its strategy of developing substantive review in a highly controlled and severely limited manner. While this breach in the wall may be expanded, and indeed others may be opened by the Supreme Court in future cases, there is no spectre of floodgates.

But what are the low hanging fruit which may be harvested through this judgment by those seeking to annul a Swiss international arbitration award? The Supreme Court was careful to say in the judgment that a violation of Art. 27 CC is not without more a contravention of

public policy. Nonetheless, a starting point is to identify the contexts in which the Swiss courts have traditionally applied Art. 27 CC. As seen in the judgment, they are in the first place situations where one party has conferred upon the other a right to make determinations about his own rights, and situations where a party's economic existence is imperilled. Particular instances of these in the case law are: i) removal of excessive restrictions on the power to terminate a contract that may otherwise be terminated at will, ii) providing for termination of contractual arrangements of excessive duration, iii) the exclusion of a shareholder from a company where that shareholder's entire economic and personal activity has been devoted to that company, and iv) the existence of a confidentiality obligation in face of a legal duty to provide information.

Endnotes

1. Decision 4A_558/2011, of 27 March 2012.
2. Decision 4A_558/2011, of 27 March 2012, consid. 4.1.
3. ATF 120 II 155, consid. E. 6a, on page 167.
4. ATF 138 II 389, consid. 2.1.
5. See for example ATF 120 II 155, consid. 6a on page 167: “The Supreme Court has not yet determined from which legal order, or value system, Swiss, foreign, supranational or universal, the concept of public policy in Art. 190(2)(e) refers to.”
6. ATF 132 II 389.
7. See for example, ATF 132 II 389, consid. 2.2.1; ATF 128 III 191, consid. 6b, page 198 (with references).
8. ATF 138 II 389, consid. 2.1.
9. Decision 4A_458/2009 of 10 June 2010, consid. 4.1.
10. ATF 119 II 380, consid. 4b, at page 384 *et seq.*; decision 4P_208/2004 of 14 December 2004, consid. 6.1.

11. Decision 4A_370/2007 of 21 February 2008, consid. 5.3.2.
12. ATF 138 II 389; see the commentary on this decision by Ph. Landolt in 24 *ASA Bulletin* 3/2006, 535-548 (“Arrêt du Tribunal fédéral du 8 mars 2006 dans la cause 4P_278/2005: commentaire”); see also Ph. Landolt, “Judgment of the Supreme Court of 8 March 2006 – A Commentary” in (2008) 19 *EBLR* 129.
13. ATF 138 II 389, consid. 2.2.2. ■