



Arbitration Newsletter Switzerland

Judex non calculat... but the Federal Supreme Court does! Should it? No!

On May 10, 2013, the Federal Supreme Court made its newest decision available on its website which deals with a violation of the right to be heard pursuant to Art. 190 (2) (d) PILA¹.

Facts

On July 1, 2010 the English company X (hereinafter "X") entered into an agreement in the format of a letter with company V (hereinafter "V"), controlled by Mr A, in order to sell different nickel products (hereinafter "the Letter").

On October 27, 2010, X and V entered into a tripartite agreement with the Swiss company Y (hereinafter "Y") under the heading "Framework Agreement" (hereinafter "the Framework Agreement"). The main purpose of the Framework Agreement was to transfer to Y all the rights conceded under the Letter to V and to make Y the contracting party of X for the sale of the nickel products.

The Framework Agreement provided for a delivery volume of 2'400 metric tons of nickel for a period of one year, starting in October 2010, and to occur out of Hull (England). The Framework Agreement was governed by English law and contained an arbitration clause for a sole arbitrator having its seat in Zurich. The Framework Agreement was commercially never executed for which Y and X blamed each other.

On September 6, 2011, Y commenced arbitration proceedings against X in which it requested payment of USD 2'320'919.54. In essence, Y claimed lost profits for the non-delivery of nickel from October 2010 to September 2011 amounting to USD 2'520'000. It calculated the amount of lost profits by multiplying the nickel quantity provided for in the Framework Agreement (2'400 tons) by USD 1'050 per ton nickel (equaling the price for which V could have re-sold the nickel on the market). From this amount Y then deducted as purchase price USD 30 per ton

nickel (USD 72'000), financial costs (USD 54'084.46), as well as insurance policy costs (USD 105'753) and added USD 32'757 for legal costs incurred in connection with the Framework Agreement.

In its reply of October 24, 2011, X opposed to Y's demand, mainly with the argument that the Framework Agreement had the legal nature of a letter of intent only, without legally binding effect. As to the amount claimed X argued that Y, for various reasons, grossly overstated this amount.

On November 17, 2011, the Zurich Chamber of Commerce nominated a London based lawyer as sole arbitrator. Thereafter, the parties exchanged their legal briefs. A hearing was held from June 20 to 22, 2012 in London. By an award rendered on October 6, 2012 the sole arbitrator ordered X to pay Y the sum of USD 1'800'000 for lost profits, plus the registration costs as well as half of the legal fees. In brief, the sole arbitrator held that the Framework Agreement was a legal binding instrument and calculated the amount of lost profits by multiplying a price of USD 750 per ton and by 2'400.

On November 12, 2012, X filed an action for annulment at the Federal Supreme Court for violation of its right to be heard, to which Y objected in its reply of February 8, 2013. The sole arbitrator abstained from commenting.

In its decision the Federal Supreme Court, after briefly dealing with formal issues, moves on to the four arguments raised by X which are all based on Art. 190 (2) (d) PILA, namely an alleged violation of the right to be heard.

Before entering into the merits of those four arguments the Federal Supreme Court however first recalls its long standing principles in the field of the right to be heard. In particular, it restates that the provision under Art. 190 (2) (d) PILA does not require that an award in an international arbitration in

¹ 4A_669/2012 of April 17, 2013, issued in French.



Switzerland be reasoned². Nevertheless, an arbitral tribunal has at least a minimum duty to examine and deal with the issues raised³. This minimum duty is violated where - by oversight or by misunderstanding - the arbitral tribunal disregards allegations, arguments, evidence and offers of evidence presented by one party being relevant for the decision to be rendered. If an award entirely neglects such elements apparently important for the solution of the dispute, it is upon the tribunal or the respondent in an action for annulment to justify this omission. It is their task to demonstrate that, contrary to the arguments of the claimant in such action for annulment, the omitted elements were not relevant for the decision or, if they were, that they have been at least implicitly rejected by the arbitral tribunal.

Nevertheless, the arbitrators have no obligation to discuss all arguments raised by the parties and a violation of the right to be heard cannot be raised due to such omission only⁴.

In the proceedings before the Federal Supreme Court X did no longer question the binding nature of the Framework Agreement but objected to the way the sole arbitrator calculated the lost profits. According to X the sole arbitrator failed to deal with four arguments it had submitted in its various submissions, in particular in its skeleton arguments of June 15, 2012. The Federal Supreme Court therefore examined all of those four arguments in light of its above established practice⁵. In doing so, it recalled that Y could only obtain a compensation for its *lucrum cessans*, i.e. the difference between the price for which it could have re-sold the nickel and the total of its costs for the acquisition of the nickel⁶.

The main argument against the award issued by the sole arbitrator was the way he calculated the purchase price.

X alleged that the price for nickel per ton is USD 30⁷, according to the clear provision in the Letter, only for uncut nickel cathodes to be delivered in Rotterdam, whereas Y expected to receive delivery of cut nickel cathodes in Hull and that the costs for cutting the cathodes (USD 150 per ton) as well as for the transport cost (USD 91 per ton, insurance included) between Rotterdam and Hull must be added to the price of USD 30. In addition, X alleged that the finance costs, estimated at USD 83 per ton, are to be added as well. According to X therefore this results in a deduction of USD 354 (30 + 150 + 91 + 83) per ton from the sales price for the cathodes (USD 525 according to X), which results then into a net lost profits of USD 171 per ton only. In X's view the sole arbitrator completely ignored all these arguments, basing his calculation on a purchase price of USD 30 per ton only.

According to the Federal Supreme Court the sole arbitrator did mention those deductions, discussed also by a financial expert, but, thereafter, apparently totally neglected to take those deductions into account in his damage calculation.

According to Y this apparent neglect is to be explained by the fact that the sole arbitrator based his damage calculation on the net price, i.e. the margin after deduction of all those deductions, whereas Y operated with the gross margin. According to Y, taking as basis for calculation the gross price of USD 1'050 and deducting USD 30 for the purchase price of the cathodes, the costs for cutting the cathodes (USD 150) and the delivery costs (USD 91 from Rotterdam and USD 23 from Hull) this results in expenses of USD 294 which then leads to lost profits of USD 756 per each ton, which corresponds, in essence, to the net margin of USD 750, as assumed by the sole arbitrator.

However, according to the Federal Supreme Court, this calculation is not convincing: from a mathematical point of view Y's calculation is not based on the same figures as those introduced by X who assumes USD 354 per ton as expenses and hence USD 696 (USD 1'050 ./. USD 354) as lost profits per ton,

2 BGE 134 III 186, consideration 6.1

3 BGE 133 III 235, consideration 5.2; "Cañas decision"

4 BGE 133 III 235, consideration 5.2

5 The Federal Supreme Court would have taken into account also the sole arbitrator's view, but - as mentioned already - he abstained from submitting any comments.

6 BGE 4A_288/2008 of September 4, 2008

7 Whatever this figure should stand for it cannot be the price for nickel per ton which is, at the time this newsletter is written, USD 14'825 on the London Metal Exchange (www.lme.com/metals/non-ferrons/nickel/)



whereas Y assumes USD 294 as expenses and, therefore, USD 756 as lost profits per ton.

The Federal Supreme Court then notes that the sole arbitrator's calculation was not based on a net result but rather on a conservative assumption, namely that the amount claimed of USD 1'050 per ton by Y would not be appropriate and should be reduced to USD 750 per ton. In doing so, he however did neither take into account all the expenses to be incurred for the purchase of the product nor did he furnish any arguments for his silence on this issue. Therefore, the Federal Supreme Court concludes that X's alleged violation of its right to be heard must be upheld.

Thereafter, the Federal Supreme Court deals with X's three other arguments why its right to be heard should have additionally be violated by the award. All those three arguments were rejected by the Federal Supreme Court and given the length it took to outline the arguments of the Federal Supreme Court in approving the first argument of Y the remaining are no longer to be dealt with in the framework of this newsletter.

But the cost allocation of the Federal Supreme Court needs to be reported. For that purpose we quote the arguments of the Federal Supreme Court in a (hopefully) verbatim translation:

"The Federal Supreme Court proceeds in this respect based on the calculation submitted in no 62 of the action for annulment, rectifying it based on the claims admitted or rejected, and comparing such amount with the result submitted by X (USD 212'000 [action for annulment, no 63] instead of USD 1'800'000 accorded by the sole arbitrator [award no 108]). Replacing the resale price per unit of USD 525 by USD 750 (cf. consideration 3.2.5 above), not considering the USD 65 for the claim of 38% by Mr A (cf. consideration 3.2.4 above) and multiplying this intermediary result by 2'400 instead of 2'000 (cf. consideration 3.2.3 above) the total to be paid by X amounts to USD 950'400 (750 ./. [30 + 91 + 150 + 83] x 2'400). Therefore X could obtain in the best case a reduction of USD 849'600 (USD 1'800'000 ./. USD 950'400), being slightly below half of the amount awarded by the sole arbitrator and significantly less (53%) than the amount it claimed (USD 1'800'000 ./. USD 212'000 = USD 1'588'000). Nevertheless, it is to be taken into account as well that X had to argue for a

procedural guaranty - its right to be heard - where its importance is not to be measured by financial aspects only (decision 4A_360/2011, cited above, consideration 7). Therefore it seems equitable to split the costs by half and to waive compensation."

Based on all of the above the Federal Supreme Court partially admitted the action for annulment by X, set its costs, to be borne equally by the parties, at CHF 17'000 in total and waived any claims for compensation of the lawyer's costs.

Conclusions

The violation of the right to be heard is the most frequent ground called upon in an action for annulment under Art. 190 (2) PILA⁸. Among the more recent cases where the Federal Supreme Court squashed an arbitral award based on a violation of the right to be heard (which results in broader terms in a violation of due process) are the following ones:

- 133 III 238 ("Cañas")⁹: the arbitral tribunal disregarded a dozen pages of arguments why Mr Cañas should, under Delaware law and the prevailing circumstances, not to be held responsible for a doping offence;
- 4A_433/2009: the arbitral tribunal did not deal specifically with three items of a damage claim;
- 4A_600/2010: the arbitral tribunal first requested the parties to file their costs incurred in the proceedings within a specific deadline but then issued its award without awaiting the parties' costs submissions¹⁰;
- 4A_46/2011: the arbitral tribunal rejected a defence according to which a claim was time bared only implicitly - which was not enough for the Federal Supreme Court;
- 4A_360/2011: the sole arbitrator overlooked a post-hearing brief.

⁸ Felix Dasser, international arbitration and setting aside proceedings in Switzerland - an updated statistical analysis, ASA Bulletin 2010/I, p. 82 et seq., in particular p. 86

⁹ See our newsletter of April 24, 2007

¹⁰ See our newsletter of August 30, 2011



But the present case seems not to fit in the above factual patterns; at best it has some similarities with the facts underlying the case 4A_433/2009, but at a closer look even this does not hold true.

In the present case, the Federal Supreme Court maintains that the sole arbitrator did not - when calculating the lost profit - properly take into account the costs Y would have incurred for the purchase and sale of the nickel. Y however maintains that the figure used by the sole arbitrator (USD 750) already reflects the net profit ("margin") and does, therefore, not call for further deductions to be itemized by the sole arbitrator. It is impossible without having access to the file of this dispute to understand what the party really pleaded and what the sole arbitrator really concluded, even if it seems that the sole arbitrator should indeed have been more explicit in his reasoning.

Be it as it may, the Federal Supreme Court should, in our view, not have entered into any discussions as to the figures of the particular case because in doing so, it embarked on a rather difficult mathematical journey! Our summary of the facts (see above), which must remain not very plausible, serves as evidence for this. The gist of the dispute seems to be whether the damage calculation is to be based on a net margin or on a gross margin minus certain cost items. The Federal Supreme Court has not only opted for the latter but directly developed its own calculation for the lost profit. Even more surprising, the Federal Supreme Court submits its very own calculation in conjunction with the cost allocation and expressly states there that Y *in the best case* could obtain now a reduction of USD 849'600 in respect of the amount awarded, or, in other words: Y could be awarded at best with USD 950'400 only!

The question therefore arises: how does the sole arbitrator in this case, which has now been referred back to him, deal with this calculation? Is this a suggestion only or rather a binding instruction? This calculation should not be binding because the Federal Supreme Court cannot review the merits of an award challenged for a violation of the right to be heard. Even less can it issue and impose its own damage calculation through the "backdoor" of its cost-allocation. The Federal Supreme Court should have, as in the past, simply annulled the award and

reverted the case back to the sole arbitrator for further decision.

In sum: the Federal Supreme Court should not have entered into the arithmetic of the case at all because: *judex non calculat!*

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Exhibit: decision 4A_669/2012