

Arbitration - Switzerland

Supreme Court: arbitrators' broad discretion to construe contractual concepts

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International arbitral tribunals are often requested to construe contractual concepts that have no precise definition in the law governing the merits of the case. Thus, they might seek guidance from other legal systems. In a recent case the Supreme Court confirmed that this practice neither exceeds the arbitral jurisdiction or contravene substantive public policy - either of which would justify annulment of the ensuing award.

(1)

Facts

A fluorite mining company in South Africa and a US incorporated fluorhydric acid-producing conglomerate had entered into a calcium fluoride supply/purchase agreement for an initial five-year contractual term, which was thereafter automatically renewed for another year unless either party terminated it at least six months before expiry of the initial contractual term. On the occurrence of a "material breach" of the agreement, the non-breaching party could terminate the agreement. The agreement contained an arbitration clause (International Chamber of Commerce, Zurich) and a choice of law provision in favour of:

"the laws of Switzerland as applied between domestic parties provided, however, that the express agreements, understandings and provisions contained herein shall always prevail."

The supplier terminated the agreement weeks after the automatic renewal of the initial contractual term, on the grounds that the purchaser had failed to settle two outstanding invoices and to release some of the information necessary to determine the purchase price for the renewed contractual term. The purchaser refuted the existence of any grounds justifying the unilateral termination and filed for arbitration, claiming full compensation for damages incurred as a result of the supplier's failure to supply the agreed quantity until expiry of the renewed contractual term. The supplier filed a counterclaim for full compensation of damages incurred as a result of the purchaser's alleged material breach.

The arbitral tribunal held that, considered individually or taken together, the alleged contractual infringements were not tantamount to any material breach within the purview of the agreement, and hence that the unilateral termination of the agreement was not justified by law. The arbitral tribunal granted part of the compensation claimed by the purchaser on that account and denied any other claims filed by the parties. In order to determine the intended meaning of the material breach test, the arbitral tribunal drew from the practice prevailing under the 1980 United Nations Convention on Contracts for the International Sale of Goods and the 2004 International Institute for the UNIDROIT Principles of International Commercial Contracts.

The supplier deferred the award to the scrutiny of the Supreme Court, arguing that the arbitral tribunal had exceeded its jurisdiction (Article 190(2)(c) of the Private International Law Act) in referring to the convention and UNIDROIT principles, since the parties' choice of law agreement was to refer to "the laws of Switzerland as applied between domestic parties". In the supplier's view, such clause should be construed as ruling out any reference to transnational rules such as the convention and the UNIDROIT principles.

Supreme Court decision

The Supreme Court upheld the arbitration award. It denied that the arbitral tribunal had exceeded its jurisdiction when construing the material breach test.(2) It also denied that

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the award was contrary to international public policy (Article 190(2)(e) of the Private International Law Act). On the contrary, the court considered that the arbitral tribunal had construed the agreement in compliance with the general Swiss law principles governing contractual interpretation. In particular, it found that the reference to transnational rules to determine the meaning of the material breach test was not unreasonable, considering the parties' longstanding international commercial practice. The court also denied that the arbitral tribunal's legal determination infringed the parties' right to be heard, insofar as such determination could hardly be considered as unpredictable and unpredictable to the parties. The court's decision would not have been different had the award been challenged under the more apposite public policy grounds, since matters pertaining to contractual interpretation are largely beyond the scope of such annulment grounds.⁽³⁾

Comment

This decision confirms the leeway that arbitrators sitting in Switzerland enjoy when construing contractual terms. Moreover, it is in line with the ICC Rules of Arbitration 1998, which provide that in all cases, when applying the rules of law on the merits, the arbitral tribunal "shall take account of the provisions of the... relevant trade usages". (Article 17(2)). Such relevant trade usages are often the necessary bridge between the parties' contractual (and commercial) relationship and the legal system chosen to govern it.

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Endnotes

(1) Supreme Court in *X v Z*, Decision 4A_240/2009, December 16 2009, released February 2010. The full text of the decision, which will not be published in the official reports of the Supreme Court's decisions, is available in the original German at www.bger.ch/fr/index/jurisdiction/jurisdiction-inherit-template/jurisdiction-recht/jurisdiction-recht-urteile2000.htm.

(2) The Supreme Court questioned whether lack of jurisdiction was a likely ground on which to challenge the award, but nevertheless examined the ground.

(3) See Supreme Court in *X v Y*, Decision 4A_268/2007, ground 3 and references.

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