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Arbitration Newsletter Switzerland

Res judicata - again!

On May 29, 2015 the Federal Tribunal (the Federal Supreme Court of Switzerland, hereinafter the "Supreme Court") rendered a further interesting decision in the field of *res judicata*[1]. When the Supreme Court published the anonymized decision it indicated also that the decision - rendered by all five members of the First Civil Chamber - is to be added to its publication of leading cases, thereby indicating that it attributes significant importance to this decision.

1. The Facts

The dispute arose between an international law firm having its seat in US ("the US Law Firm") and an attorney having his domicile in Germany ("the Lawyer"). On July 1, 2008 a "Business Combination Agreement" ("BCA") was entered into between the US Law Firm and, amongst others, the Lawyer in respect of a German law firm ("the German Law Firm"), of which the Lawyer was a founding member and which resulted in the combination of the German Law Firm with the US Law Firm.

Article 5.2 and 5.3 as well as Schedule 5 of the BCA provided that the Lawyer was entitled to an annual Floor Amount. The relevant provisions of the BCA read as follow:

> *"5.2 Schedule 5 sets forth the initial share of each of the partners of [the German Law Firm] in Net Income and, where applicable, Net Loss. The tier placements assigned in Schedule 5 to [the Lawyer] are valid until 2010 (inclusive). All other tier placements (regardless of whether these are variable and/or fixed) are valid until 2009 (inclusive). The Floor Amount indicated in Schedule 5 [EUR 2 Mio.], which represent minimum amounts per annum payable to the partners of [the German Law Firm], are valid until 2012 (inclusive), subject, however, to Sub-Clause 5.3.*
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> *5.3 The tier placements and Floor Amount set out in Schedule 5 for each partner of [the German Law Firm] are agreed with the understanding that the respective partner of [the German Law Firm] will continue as active partner of [the US Law Firm] devoting his/her full time and efforts to the business of the [US Law Firm] going forward consistent with his/her past practices and concentrations as a partner of [the German Law Firm], which is to be considered based on a holistic approach taking into consideration all relevant aspects (disregarding, however, past individual deviations from common standards, e.g. over- or underperformance in total or billable hours per year) including, among others, billable and total hours, availability, vacation, quality of work, turn-over from billable hours, general market conditions in a specific industry and potential effects of the business combination contemplated herein, it being understood that no single aspect alone shall be decisive and that it will be taken into account to which extent these factors are under the control of the respective partner of [the German Law Firm]."*

The BCA provided for the application of German law and contained the following arbitration agreement at Article 12.3:

> *"All disputes arising out of or in connection with this Agreement shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce ('ICC') by three arbitrators appointed in accordance with the said Rules. The place of arbitration shall be Zurich, Switzerland. The arbitration*

[1] 4A_633/2014 (in German).

proceeding shall be conducted in the English language."

Subsequently, differences arose between the Lawyer and the US Law Firm as to the payments provided for under Articles 5.2 and 5.3 BCA. Consequently, the Lawyer commenced arbitration proceedings under the ICC rules against the US Law Firm requesting, amongst other, payment of the difference between the annual Floor Amount of EUR 2 Mio. for each of the years 2009 and 2010 and the amounts actually paid out to him in respect of those two years. The ICC arbitral tribunal ("the Frankfurt ICC Tribunal"), which had its seat chosen in a specific separate agreement between the parties as to that issue, rejected the claim of the Lawyer in its award dated September 30, 2011. In its considerations the Frankfurt ICC Tribunal stated that the Floor Amount pursuant to Art. 5.2 BCA was owed only if a partner had fulfilled the prerequisites under Art. 5.3 BCA providing for *"activities, devotion and performance"* and concluded that the Lawyer had not satisfied such prerequisites in the relevant period.

On April 23, 2013 the Lawyer initiated a second arbitration proceeding requesting the US Law Firm to pay EUR 1'662'933 and EUR 1'843'302, being the difference for the amounts owed under Art. 5.2 and 5.3 BCA as Floor Amount (namely 2 Mio. EUR each for 2011 and 2012) and the amounts actually paid out to him by the US Law Firm in respect of those two years.

On July 18, 2013 the two party-appointed arbitrators were confirmed by the ICC and on September 19, 2013 the chairman of the arbitral tribunal ("the Zurich ICC Tribunal") was appointed by the ICC Court.

The US Law Firm raised the defence of *res judicata* which the Zurich ICC Tribunal rejected in Procedural Order No. 3 dated February 12, 2014. Since the US Law Firm raised some arguments as to its right to be heard with regard to this Procedural Order No. 3, the Zurich ICC Tribunal granted the parties a further opportunity to plead certain issues in this respect and then reconfirmed its decision to reject the defence of *res judicata* in Procedural Order No. 5, issued on March 18, 2014 and incorporating exhaustive reasoning. Subsequently, in its award, the Zurich ICC Tribunal declared itself not bound by the interpretation of Art. 5.3 BCA by the Frankfurt ICC Tribunal on September 30, 2011 and, consequently, developed an independent interpretation. In doing so, it did consider the arguments provided by the Frankfurt ICC Tribunal but came, nevertheless, to a different result under its contractual interpretation. Specifically, the Zurich ICC Tribunal put more weight on the *"holistic approach"* required under Art. 5.3 BCA: the Zurich ICC Tribunal accepted that the Lawyer did not fulfill the expectations as to billable hours and turnover but found that he met all other criteria established under Art. 5.3 BCA, such other criteria being the majority. In doing so, the Zurich ICC Tribunal held that the Frankfurt ICC Tribunal had a rather one-sided approach, giving an overwhelming weight to the two elements *"billable and total hours"* and *"turnover from billable hours"* which, in the view of the Zurich ICC Tribunal, was not compatible with the required "*holistic approach*". Consequently, the Zurich ICC Tribunal admitted the claim of the Lawyer for the Floor Amount for the years 2011 and 2012 but concluded nevertheless that based on § 254 BGB[2] the Lawyer's claim should be reduced due to his contributory negligence. Consequently, in its award of September 29, 2014 the Zurich ICC Tribunal accepted the Lawyer's claims in the reduced amount of EUR 1'997'221.[3]

Subsequently, the US Law Firm filed an action for annulment of this award.

2. Considerations

2.1 Procedural Issues

First, the Supreme Court reconfirmed that the standard reference to the ICC rules, in particular its Art. 34(6)[4], does not qualify as a waiver of an action for annulment pursuant to Art. 192 PILA - as pleaded by the Lawyer at the Supreme Court[5].

Since both the Lawyer and the Zurich ICC Tribunal took the view that the filing of the US Law Firm's action for annulment should have been lodged within

2 On contributory negligence.

3 Instead of EUR 3'506'235, as originally claimed, see above.

4 *"Every award shall be binding to the parties. By submitting the dispute to arbitration under the Rules, the parties undertake to carry out any award without delay and shall be deemed to have waived their right to any form of recourse insofar as such waiver can validly be made."*

5 BGE 134 III 260 consid. 3.1 and BGE 133 III 235 consid. 4.3.1.

30 days after the issuance of Procedural Order No. 5 and therefore was out of time, the Supreme Court had also to clarify this issue. In doing so it made it clear that the decision reached in Procedural Order No. 5 did not rule on a disputed claim in an all-embracing manner. Instead, Procedural Order No. 5 addressed a preliminary question and its decision did not even partially put the arbitral proceedings to an end[6]. Consequently, Procedural Order No.5 had not constituted a partial award which would have had to be challenged within 30 days after its issue.

Next, the Supreme Court had also to dispose of the Lawyer's argument according to which the decision in Procedural Order No. 5 in not admitting the defense of *res judicata* was also a decision as to the jurisdiction of the Zurich ICC Tribunal. The Supreme Court rejected this argument and pointed out that interim decisions pursuant to Art. 190(3) PILA can be challenged only for irregular composition of the arbitral tribunal pursuant to Art. 190(2)(a) PILA and for lack of jurisdiction of the arbitral tribunal respectively (Art. 190(2)(b) PILA). As recently established[7], in raising those two possible arguments a party seeking the annulment of a preliminary award may also raise further grounds as provided for under Art. 190(2) PILA but only insofar as those further grounds - in particular as to the right to be heard - are strictly tied to the above two mentioned grounds for challenging interim and partial awards.

Consequently, the Supreme Court held that the remedy under Art. 190(2) PILA was available neither against Procedural Order No.3 nor against Procedural Order No.5. Therefore, the arguments of the US Law Firm could be brought forward only once the final award of the Zurich ICC Tribunal had been issued.

2.2 The Arguments of the US Law Firm

The US Law Firm argued that the Zurich ICC Tribunal had violated the procedural public policy because it did not respect the legal force (*materielle Rechtskraft*) of the award rendered by the Frankfurt ICC Tribunal. The US Law Firm did not, however, argue that the claim raised before the Frankfurt ICC Tribunal was identical with the claim raised before the Zurich ICC Tribunal. It acknowledged that the first claim was based on the Floor Amount for 2009 and 2010, whereas the claims raised in the second proceedings - the Zurich ICC proceedings - covered the claims for the Floor Amount 2011 and 2012. Instead, the US Law Firm argued that the first award had prejudicial value for all preliminary and partial questions to be decided by the Zurich ICC Tribunal and, therefore, the second tribunal should have respected "*the binding statements in legal and factual matters of the first Arbitral Tribunal*".

According to the US Law Firm the international concept of *res judicata* should apply in arbitration proceedings with international parties. The binding force of an arbitral award by a foreign arbitral tribunal should therefore not be identical to that of a judgment rendered by a national state court. The underlying reason for this is the differing interests between parties of international arbitration proceedings and parties in national state court proceedings in Switzerland. Therefore, the legal force should also cover the considerations of the first award against which the second award is to be mirrored for *res judicata* purposes. The US Law Firm found guidance for this conclusion in the final report of the International Law Association on *res judicata* and arbitration which provides for a large area of application of the *"conclusive and preclusive"* effect in the field of *res judicata,* also covering issues of facts and law[8].

The legal force of the award of the Frankfurt ICC Tribunal should, according to the US Law Firm, embrace also its considerations why the Floor Amount was owed only once the particular performance criteria as to *"billable hours"* and *"turnover from billable hours"* pursuant to Art. 5.3 BCA had been met in the year in question. The Zurich ICC Tribunal should have been bound to these legal considerations and should not have been able to have arrived at different conclusions as to the pre-requisites to be met under Art. 5.3 BCA for the annual Floor Amount. In deviating in this respect and in concluding that the two criteria *"billable hours"* and *"turnover form billable hours"* would not suffice to deny the Lawyer payment of the Floor Amount, the Zurich ICC Tribunal had - as argued by the US Law Firm - put itself in a contradictory position to the final

[6] BGE 140 III 520 consid. 2.2.1.; see also our Newsletter of October 30, 2014: *"The Supreme Court clarifies the grounds for annulment against preliminary and interim awards."*

[7] BGE 140 III 477 consid. .3.1.

[8] Resolution No. 1/2006 of the 72th Conference of the International Law Association held in Toronto.

conclusions of the Frankfurt ICC Tribunal and, therefore, the procedural public policy pursuant to Art. 190(2)(e) PILA had been violated.

Even if the national understanding of *res judicata* would have been applicable, the Zurich ICC Tribunal would still have been bound by the conclusions of the Frankfurt ICC Tribunal as to the Floor Amount since - also pursuant to the case law of the Supreme Court - such considerations should have prejudicial value.

2.3 The Considerations of the Supreme Court

As a first step, the Supreme Court referred to its definition of public policy and the distinction it makes between procedural public policy and substantive public policy, citing its own leading decisions in this respect[9]. Procedural public policy is violated, amongst other, if an arbitral tribunal disregards the legal force of a previous decision or if it deviates in its final decision from its view communicated in an interim decision with regard to a preliminary question. The Supreme Court then reiterated that the legal force was to be respected on both the national and international levels. If therefore a party raises a claim at an arbitral tribunal having its seat in Switzerland when such claim is identical to a claim already finally adjudicated by a foreign state court or a foreign arbitral tribunal, the arbitral tribunal in Switzerland can no longer accept the claim if the foreign decision is recognised in Switzerland pursuant to Art. 25 and Art. 194 PILA respectively. The identity of a claim is established by applying the *lex fori*.

The legal force of a foreign decision cannot go further than the identical decision of a Swiss court or an arbitral tribunal having its seat in Switzerland would have. If the legal force of the foreign decision according to the law under which it has been rendered would also embrace the considerations of such court, such effect would have to be limited in Switzerland to the dispositive part of this decision[10]. On the other hand, a decision rendered by a foreign court or a foreign arbitral tribunal cannot create additional effects in Switzerland which it would not have had in the state such decision is originating from.

Having reiterated all these principles, the Supreme Court then returned to the facts of the case and rejected the first argument of the US Law Firm, namely that the Supreme Court had so far not rendered any decision as to whether the legal force of an award has the same effect as a judgement of a Swiss state court: the Supreme Court has applied, for quite some time now, the same principles as to the legal force of decisions of arbitral tribunals. In doing so it made it clear that the legal force of an international arbitral award is restricted to the dispositive part and its considerations do not form part of *res judicata*[11]. In a more recent decision concerning the legal force of a foreign arbitral award, the Supreme Court applied the same principles as for a judgement of a foreign state court[12].

In addition, the Supreme Court reiterated that once an arbitral tribunal has rendered its award such award has the same effect as a decision of a state court where this is, in particular, stated for national arbitrations in Art. 387 CPC[13]. The same effect also applies to decisions rendered by international arbitral tribunals having their seat in Switzerland.

The above principles cannot, according to the Supreme Court, be modified as required by the US Law Firm, neither by *"the specific interest of parties in an international arbitration proceeding"* nor by the desirability of having international uniform standards and transnational concepts applicable *res judicata*[14]. To that end the Supreme Court noted that the US Law Firm did not even argue that the New York Convention or any other applicable treaty would provide otherwise. The application of a broader international understanding of the term "legal force" *"according to the world-wide concept of Anglo-US origin"*, as pleaded by the US Law Firm, was consequently not founded on any legal basis.

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9 BGE 140 III 278; see also our Newsletter of June 25, 2014: *"Res judicata - does the Federal Supreme Court open new doors?"* 136 III 345 consid. 2.1. (Club Atletico de Madrid SA vs Sport Lisboa Benfica Football SAD, see also our Newsletter of June 6, 2010) and 132 III 389; consid. 2.3.1.

10 BGE 140 III 278 consid. 3.2

11 BGE 128 III 191 consid. 4a.

12 BGE 4A_508/2010 of February 14, 2011, consid. 3.3.

13 *"Once notice of the award has been given to the parties, it has the effect of a legally-binding and enforceable judicial decision."* (CPC = Civil Procedural Code of Switzerland).

14 Pursuant to the ILA Recommendations referred to in fn. 8 above.

In addition, the US Law Firm ignored that the effect of the legal force of a foreign arbitral award are determined by that award itself which can have legal effect in Switzerland only insofar it did so in the jurisdiction in which the award had been rendered. The US Law Firm had failed to have established that the arbitral award rendered by the Frankfurt ICC Tribunal would, according to applicable German law, have legal effect going beyond the dispositive part and embracing also the considerations of such decision. Therefore, the binding effect of the Frankfurt ICC award of September 30, 2011 was to be adjudicated according to the principles established by the Supreme Court as to "legal force".

Next, the Supreme Court turned to the second argument of the US Law Firm according to which the Zurich ICC Tribunal would remain bound by the decision of the Frankfurt ICC Tribunal even if the established principles of the Supreme Court as to *res judicata* were to be applied. Rejecting this argument, the Supreme Court held that "legal force" went only as far as the decision rendered in the Frankfurt ICC Tribunal went. To answer this question, the Frankfurt ICC award has to be considered in full since the range of the dispositive part can regularly be determined only after consideration of the underlying reasoning[15]. Therefore, the Zurich ICC Tribunal had indeed to consult the reasoning of the Frankfurt ICC Tribunal - which it did: in its Procedural Order No.5 of March 18, 2014, it rejected, with full reasoning, the US Law Firm's defence as to *res judicata*. It had, in particular, held that the claim in the Zurich ICC proceedings was not identical with the claim adjudicated in the Frankfurt ICC proceedings since the former was about the Floor Amount for 2011 and 2012 whereas the Frankfurt ICC Tribunal decided on the Floor Amount for 2009 and 2010. Contrary to what the US Law Firm argued at the Supreme Court, there was no further binding effect as to the legal considerations of the Frankfurt ICC Tribunal in its interpretation of Art. 5.3 BCA[16]. Only if the Frankfurt ICC Tribunal had, by way of a declaratory award, rendered a decision as to how the qualifying terms for the Floor Amount have to be interpreted would the question of any binding effect of this decision arise but no such declaratory relief had been sought in the Frankfurt ICC proceedings.

Consequently, the Zurich ICC Tribunal decided a different claim to that decided by the Frankfurt ICC Tribunal and, therefore, it could deal with the claims raised by the Lawyer "ab initio", i.e. without being bound either to the facts or to the legal conclusions as established by the Frankfurt ICC Tribunal.

In concluding, the Supreme Court held that the Zurich ICC Tribunal had not violated procedural public policy in rendering its decision based on its own interpretation of Art. 5.3 BCA. To the contrary: the Zurich ICC Tribunal would, according to the Supreme Court, actually have violated procedural public policy if it *had* felt itself bound by the contractual interpretation of the Frankfurt ICC Tribunal and it would, therefore, not have addressed the merits of the case had it simply dismissed the Lawyer's claim based on *res judicata*.

3. Conclusions

As Hansjörg Stutzer was involved in the Zurich ICC proceedings it would seem inappropriate to present here an in-depth analysis of this Supreme Court decision. We therefore restrict our conclusions to the statement that this Supreme Court decision has drawn a clear line. Whilst the Supreme Court seems willing to apply a more liberal standard in establishing the identity of the parties - as further developed in its very recent decision on *res judicata*[17] - it makes clear that no such softening of its standard applies to the identity of the claims. Specifically, the Supreme Court does not, in this area, open any doors to the application of common law standards, such as issue estoppel.

[15] BGE 136 III 345 consid. 2.1.
[16] BGE 121 III 474 consid. 4a.

[17] BGE 140 III 278 consid. 4.2.1.: *"This being so, one may seriously consider whether in situations so specific as the one at hand, a less formalistic approach to the concept of identity of the parties would not be called for. It would make it possible to take into account the singular role played in the state proceedings initiated abroad, at first by the party that is absent in the subsequent arbitral proceedings in an arbitral tribunal sitting in Switzerland and to obstruct any possible maneuvres seeking to torpedo the arbitration. In such exceptional cases, it would then be appropriate to engage in a more in-depth review of the situation without giving too much importance to the formalistic criteria of the participation of the signatories of the arbitration agreement in both litigations, even though this may somewhat affect certainty as to the law."*
(Translation courtesy of Charles Poncet, Geneva, www.swissarbitrationdecisions.com).

June 17, 2015

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Enclosure:
BGE 4A_633/2014 of May 29, 2015 (in German).