

Arbitration or state courts? The material limits of an arbitration clause that concerns the interpretation and application of a contract

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Legal proceedings initiated in order to enforce a loan contract fell outside the (narrow) scope of an arbitration clause that was limited to the interpretation and application of the relevant agreement.

Judgment of the Federal Supreme Court of 2 November 2020

Case Reference : [4A_151/2020](#)

Facts

The dispute concerned a loan. On an undisclosed date, the lender transferred an amount of EUR 500,000 to the borrower. By a later agreement executed on 30 June 2006, the parties confirmed that this transaction constituted a formal loan. Under the terms of the agreement, the borrower undertook to repay the EUR 500,000 with interest by 30 June 2006; he also formally declared himself debtor to that sum under Swiss insolvency law (which constituted an acknowledgment of debt within the meaning of [Art. 82 of the Federal Debt Enforcement and Bankruptcy Act \[DEBA\]](#)). The loan agreement further contained conflicting dispute resolution clauses: first, a general jurisdiction clause under which all disputes under the contract should be brought before the courts of Lugano (Switzerland), and, second, an arbitration clause stating that specific disputes on the interpretation and application of the contract should be brought before a single arbitrator (the said clause states [in Italian]: “*sull’interpretazione e sull’applicazione della presente convenzione*”).

On 23 March 2005, the parties concluded a second loan agreement, drafted under the same terms, for the additional sum of EUR 250,000 with a maturity date of 1 March 2007.

Around a year later, on 29 March 2006, the borrower acknowledged his total debt of EUR 750,000 (a) by signing an account statement in favor of the lender, and (b) by constituting, through a further agreement executed with the lender, a collateral on his above-mentioned debt by pledging several shares he owned in a company.

With the borrower having failed to repay the amount of the loan by the contractually agreed maturity dates, the lender sued the borrower before the courts in Lugano for the sum of EUR 750,000. Among other arguments, the borrower disputed the jurisdiction of the courts by claiming that the dispute fell within the scope of the arbitration clause.

Issue

What is the material scope of an arbitration clause limiting the arbitrator’s competence to disputes over the interpretation and application of the relevant contract? Does this substantive scope cover legal proceedings initiated in order to request the performance of the contract?

Decision

Under Swiss law, interpretation of contractual clauses – including arbitration clauses – rests upon an examination of the true and common intention of the parties, which prevails over the objective method of contract interpretation based on a plain meaning of the text ([Art. 18 of the Swiss Code of Obligations \[SCO\]](#)). On that basis, the FSC found that the arbitration clause was meant by the parties to only cover disputes centered on the interpretation and application of the loan contracts. The lender’s claim in repayment of the loan, which sought performance of the borrower’s repayment obligation under the contract, was not such a dispute and therefore fell outside of the scope of the arbitration clause. Based on this reasoning, the FSC rejected the borrower’s challenge to the jurisdiction of the Swiss courts and affirmed their jurisdiction over the matter.

Another interesting issue which was resolved by the FSC in this decision is mentioned below.

Under [Art. 257 of the Swiss Civil Procedure Code \(SCPC\)](#), claimants in civil proceedings may file their suits under expedited summary proceedings when their claims concern so-call “*clear cases*” (*cas clairs*). Clear cases are those disputes in which (a) the facts are either undisputed by the parties or directly documented by proof, and in which (b) the legal situation is clear enough to be immediately resolved by the judge.

In the case at hand, the lender filed suit before the lower court in Lugano under expedited proceedings, arguing that the borrower’s multiple written acknowledgements of the full amount of the loan directly provided the legal grounds for his claim in reimbursement (under [Art. 82 DEBA](#)), which in his view led to a clear case. The borrower disputed this point before the FSC. He alleged that the agreements and declarations that he signed in relation to his debt did not reflect the actual dealings between the parties, which he portrayed as complex and tainted by several acts of misrepresentation on the part of the lender. Ultimately, the FSC sided with the lender and found that the documentation at hand was sufficient to clearly establish the claim in payment and thus capable of being adjudicated under expedited proceedings as a clear case.

Key takeaway

This case illustrates the risks of careless contract drafting resulting in conflicting dispute resolution clauses. In this case, the FSC held that legal proceedings for the enforcement of contractual obligations fell outside the scope of the arbitration clause limited to the interpretation and application of the contract.

Comments

The FSC’s decision appears sound when confronted with the specific facts of the case at hand, in which the lender’s claim in payment was unambiguously supported by the terms of the parties’ agreements. One may, however, question whether the Supreme Court’s decision may still be valid in situations in which the enforcement of a contract would require the interpretation of its terms.

This dispute illustrates the risks for parties in drafting so-called “hybrid dispute resolution clauses” by which the parties decide to split the jurisdictional powers between courts and arbitral tribunals depending on the nature of the disputes that may arise between them. Indeed, such clauses may cause difficulties in case of overlap between the respective jurisdictional powers of arbitral tribunals and/or state courts. Parties to commercial contracts may avoid these risks by opting for a single forum to decide all disputes arising under their agreement.

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