

October 2007 Information Letter

Court of Arbitration or State Court – a difficult choice

I. Situation

Within the framework of contract negotiations, particularly those between parties from different countries, the inevitable question is bound to arise sooner or later as to whether a clause should be incorporated in the contract that provides for the jurisdiction of State Courts or for the jurisdiction of a Court of Arbitration in the case of a dispute. A recently published study by PricewaterhouseCoopers (“International arbitration: Corporate attitudes and practices 2006”) showed that the use of a Court of Arbitration for the settlement of disputes which transcend national boundaries is strongly endorsed by international companies. The flexibility of the process, the expertise of the arbitrator, finality (only a single instance) and confidentiality are normally given as the most important benefits of Arbitration Courts over state proceedings. High costs are usually cited as a disadvantage under the jurisdiction of a Court of Arbitration.

The most important differentiating features between state jurisdiction and Court of Arbitration jurisdiction from our perspective are presented in greater detail below. In the comparison, a Court of Arbitration set up following the international arbitration rules of the Swiss Chambers of Commerce (subsequently referred to as “Court of Arbitration”) is compared with the Commercial Court of the Canton of Zurich (subsequently referred to as “Commercial Court”) as an alternative. A prerequisite is that there must be a combination of circumstances that allows for both the adoption of the provision of the Court of Arbitration and the provision of the Commercial Court.

Such a combination of circumstances is in principle the case if (in the sense of cumulative

requirements) it concerns a Swiss company and a foreign company; the contract covers the business carried out by the contractual parties; an amount of CHF 30,000 is reached in litigation; the dispute concerns proprietary claims and the contractual relationship is subject to Swiss law. Other combinations are possible as well.

II. Distinguishing characteristics of the Court of Arbitration set up as per the Swiss rules of arbitration – Zurich Canton Commercial Court

1. Cooperation of the parties in the composition of the court

a. Court of Arbitration

When a Court of Arbitration is chosen, the arbitrators are appointed with the consent of the parties before the actual court proceedings take place. In other words, the agreement on a Court of Arbitration offers the parties the possibility to exert an influence on the composition of the adjudicating panel and to choose experts who are familiar with complex proceedings and demonstrate specific legal, technical or linguistic knowledge. The naming of specialist arbitrators means that expensive expert opinions may be waived, contrary to State Courts where consultation is mandatory. The possibility of exerting an influence on the composition of the Court of Arbitration does not in any way alter the fact that all arbitrators are neutral and fully independent of the parties.

b. Commercial Court

If the parties choose to use the Commercial Court there is no possibility of exerting

influence on the composition of the court. However, efforts are also made at the Commercial Court to ensure that experts with specialist knowledge collaborate in the reaching of a verdict. The Commercial Court is made up of two members of the Higher Cantonal Court and three commercial judges. The commercial judges are persons who possess specialised knowledge from a wide range of fields.

2. Proceedings

a. Court of Arbitration

The proceedings in the Court of Arbitration begin with the submission of the so-called Notice of Arbitration by the plaintiff at a Chamber of Commerce. The Notice of Arbitration contains essential information such as the names and addresses of the parties, claims sought, proposal of arbitrator, etc. The defendant then has 30 days following delivery to submit the Answer to the Notice of Arbitration (preliminary statement).

After the appointment of the arbitrators (a one or three member panel) the proceedings take place. Under the Swiss rules of arbitration both parties are each entitled to a single statement (Statement of Claim and Statement of Defence). The Court of Arbitration may decide to arrange further written statements. Then the evidentiary proceedings take place which usually constitute the examination of witnesses and the questioning of experts. The application of procedural elements that originate from foreign legal systems (cross-examinations; written witness statements; questioning of witnesses by party attorneys out of court, so-called depositions) is also possible.

After the evidentiary proceedings have taken place, the Court of Arbitration issues an arbitration judgement which is irrevocably binding (appeals to the Federal Court are only admissible for a small number of formal reasons).

b. Commercial Court

In the Commercial Court proceedings, both parties are entitled to two briefs each. Between the first and second exchange of briefs, the Commercial Court arranges a preliminary hearing and conciliation procedure. The purpose of this hearing is to give the parties substantiating advice within the framework of

the judicial duty to provide information. The Commercial Court also informs the parties of its provisional assessment of the legal position at this time and makes a concrete conciliation proposal to the parties. Many Commercial Court proceedings are closed with conciliation at this point.

In the event of no conciliation between the parties, the second exchange of briefs takes place which is followed by the evidentiary proceedings. The focus in the evidentiary proceedings lies on the questioning of witnesses and the consultation of expert opinions.

The Commercial Court then issues its verdict. This can be disputed by the unsuccessful party through right of appeal (nullity appeal at the Zurich Canton Court of Appeal; appeal to Federal Court).

3. Language

a. Court of Arbitration

For the Court of Arbitration proceedings, the parties or the Court of Arbitration (in the event of no agreement between the parties) can freely decide on the language in which the proceedings will be heard. The English language is often chosen for international proceedings. The advantage of choosing the language means that the time and cost-intensive operation of translating the submitted documents and calling in interpreters incurred by State Courts can be avoided.

b. Commercial Court

Proceedings at the Commercial Court of the Canton of Zurich are conducted in German. The Commercial Court can insist on the translation of documents in foreign languages – in order to safeguard the legal hearing. By contrast the Commercial Court will forego a translation if the court and the opposing party have an adequate knowledge of the foreign language.

4. Publicity / Confidentiality

a. Court of Arbitration

The desire to maintain secrecy and discretion is often given as a reason for giving preference to the Court of Arbitration over the State Court.

There is a higher degree of confidentiality at Courts of Arbitration as the arbitration procedure is a private event unlike the proceedings in State Courts: in addition, there is no public hearing and the judgements are not published. In many cases the actual fact that there was a legal dispute will not be known to the public. Furthermore, publicizing the economic situation of the company in a lawsuit is often avoided. This also helps to ensure that production and business secrets are protected. In accordance with the Swiss rules of arbitration, the parties and the arbitrator are obliged to maintain secrecy on all arbitration verdicts and the measures taken, as well as on all documents that are submitted within the framework of the arbitration procedure.

b. Commercial Court

In principle, the proceedings in a Commercial Court are a public event. In exceptional circumstances – following a corresponding application by one party – the proceedings may be heard in camera. This may be the case if there is a threat to public order and safety; if morals and decency are endangered or if a party's interests that are worthy of protection, have to be taken into account, for example in the case of production and business secrets.

5. Neutrality and Independence

a. Court of Arbitration

The fact that both parties are entitled to choose an arbitrator constitutes a significant guarantee that a Court of Arbitration will pass judgement independently.

b. Commercial Court

Foreign parties often fear that proceedings in a Swiss State Court will be disadvantageous to them. This fear is to be dismissed as unfounded. The Zurich Canton Commercial Court has an excellent reputation and no disadvantage will arise from being a non Swiss party.

6. Court Costs

The court costs are to be paid by the unsuccessful party in both Court of Arbitration and Commercial Court proceedings. In both cases they are in principle in line with the

disputed amount and the difficulty of the case. Nevertheless, Commercial Court costs are considerably lower than Court of Arbitration costs. The following examples of costs will give an approximate idea of the amounts of the fees for arbitrators in comparison to the court charges due to the Commercial Court:

Disputed Value: 2 million CHF:

Court of Arbitration fee:

One member panel CHF 30,000 - CHF 120,000

Three member panel: CHF 75,000 - CHF 300,000

Commercial Court charges:

CHF 20,300 - CHF 40,600

Disputed value: 10 million CHF:

Court of Arbitration fee:

One member panel CHF 60,400 - CHF 240,000

Three member panel: CHF 151,000 - CHF 600,000

Commercial Court charges:

CHF 60,300 - CHF 90,500

In order to assure the fee of the Court of Arbitration, the Court of Arbitration requires an amount to be paid in advance by both the plaintiff and the defendant. This amount corresponds to the expected fee of Court of Arbitration and each party must pay half of the amount.

The situation is different in the case of proceedings in the Commercial Court. In accordance with the Zurich Code of Civil Procedure, a foreign plaintiff is, in principle, obliged to pay a security deposit for costs and compensation. Nevertheless international agreements establish that the citizens of many states (e.g. Germany, Italy, Austria, France, however not the USA) do not have to comply with the duty to pay a security deposit. On the other hand, individuals and corporate plaintiffs located in Switzerland involved in proceedings against individuals and companies located abroad may have a duty to pay a security deposit (to cover the costs).

7. Legal Costs

a. Court of Arbitration

In proceedings in the Court of Arbitration under the Swiss rules of arbitration and in proceedings at the Commercial Court of Zurich Canton, the unsuccessful party must pay the legal costs to the successful party. In proceedings in the Court of Arbitration under the Swiss rules on arbitration, the legal costs will be of an amount which the Court of Arbitration deems appropriate. As a rule it may be assumed that the amount of legal costs to be paid by the unsuccessful party corresponds to the effective attorney costs of the opposing party or at least comes close to matching them.

b. Commercial Court

In contrast to this, the amount of legal costs to be paid to the opposing party in proceedings in the Zurich Canton Commercial Court is established by a tariff system and is aligned on the basis of the arrangement on the attorney fees. For a disputed value of 1 million CHF, the basic tariff which the unsuccessful party must pay to the successful one amounts to CHF 31,400. For a disputed value of 10 million CHF, the basic tariff amounts to CHF 106,400.

Experience indicates that the amount which the unsuccessful party has to pay for legal costs is generally (considerably) less in the Commercial Court than in the Court of Arbitration.

III. Conclusion

A decision for or against a Court of Arbitration should be thought through carefully. The differences between the procedures should not be underestimated from a cost perspective.

In our opinion the following non-definitive principles should be adhered to:

- The choice of a Court of Arbitration is suitable for parties to whom the aspects of confidentiality and the participation in the composition of the court are of great importance and who do not fear high costs.
- The choice of a Court of Arbitration may also be advantageous if the contracts are complex (building of industrial installations

for example) and written in a foreign language.

- By contrast, the choice of a Commercial Court is preferable if the cost aspect is a key factor for the parties.
- Due to the high costs inherent in the Court of Arbitration when compared to the Commercial Court, it is our opinion that an arbitration clause should only be considered, at least in cases where financial considerations are of great importance, if the expected disputed value represents a minimum amount. In our experience and in our estimation the threshold value should exceed CHF 1 Mio. at least.

Contact

The contents of this Information Letter do not constitute legal information and may not be used as such. For personal advice please consult your contact person at Suter Howald Attorneys at Law. For further questions in relation to the topic of this newsletter please contact:

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