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Client Alert

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International Arbitration in Switzerland – Flashback To 2022

In 2022, Switzerland continued to be one of the leading venues for international commercial and investment arbitration with an active community and Swiss Arbitration Centre at the forefront of the development of efficient dispute resolution. In this International Arbitration in Switzerland - Flashback to 2022, we report on two interesting developments that confirm the efficiency of international arbitration in this small country at the heart of Europe.

I. The Federal Supreme Court ruling on the application of the Energy Charter Treaty in Yukos vs. Russian Federation

Yukos Capital ("**Yukos**") is a Luxembourgish company and a former wholly owned subsidiary of Yukos Oil, a Russian company that went bankrupt after being hit with multibillion dollar retroactive tax demands by the Russian government. Yukos had granted loans to its parent and lost these funds in the bankruptcy.

In 2013, Yukos initiated arbitration proceedings under the Energy Charter Treaty ("**ECT**") against Russia seeking compensation for the illegal expropriation of its investment (the loans). Russia immediately raised several objections to the jurisdiction of the Geneva-seated arbitral tribunal.[1] The Arbitral Tribunal dismissed three of Russia's five objections in an interim award on jurisdiction in early 2017, reserving the last two objection for adjudication with the merits of the case. Russia challenged the Interim Award before the Federal Supreme Court of Switzerland ("**FSC**"), which promptly found it inadmissible and dismissed it. The arbitral tribunal still had to rule on two jurisdictional objections and therefore the issue of the arbitral tribunal's jurisdiction was not yet ripe for review by the FSC.

The arbitral tribunal issued its final award in 2021, ordering Russia to compensate Yukos for one of its multi-billion loan reduced by 50%, in consideration of Yukos' contribution to its loss. Russia applied to the FSC to set aside both the interim and the final awards on the ground that the arbitral tribunal lacked jurisdiction. The FSC's ruling involved very interesting interpretations of the ETC, its application and the key terms:

investment and investor. Russia's first objection related to the provisional application of the ECT in Article 45 – Provisional Application: "*Each signatory agrees to apply this Treaty provisionally pending its entry into force for such signatory in accordance with Article 44, to the extent that such provisional application is not inconsistent with its constitution, laws or regulations*." Russia argued that it never ratified the ECT and is therefore not bound by its arbitration clause (in Article 26 of the ECT). In the interim award, the Arbitral Tribunal had held by majority that Russia was bound by the provisional application of the ECT. The FSC reviewed the interpretation of the ECT, the mechanism of provisional application of international treaties, and the specific disputed issue of whether Russia could validly oppose the provisional application of the arbitration clause in Article 26 of the ECT on the ground of incompatibility with Russian legal order as the ECT expressly reserves.

In a long and detailed judgement,[2] the FSC upheld the arbitral tribunal's finding that Russia had indisputably and without reservation consented to the application of the provisional application of the ECT dispositions including the unconditional agreement to resolve disputes by arbitration. In reaching this conclusion, the FSC established several interesting points. First it noted that the purpose of provisional application is to assimilate a signatory state with a contracting party until the expiration of the provisional application regime (i.e., ratification or renunciation). Then, the reservation in Article 45 ECT for inconsistency of treaty provisions with Russian legal order shall be construed as an exception and not a requirement that national legislation specifically authorizes the provisional application of treaties. Russia bore the burden of demonstrating that the provisional application of the treaty generally and the arbitration agreement specifically are inconsistent with its legal order – which Russia failed to do. In fact, Russian law expressly contemplates arbitration as a mechanism for the resolution of disputes with a foreign investor.

The FSC also clarified that national legislations constantly evolve and the relevant point in time to assess the existence (or lack) of an incompatibility is the initiation of the arbitration. Incompatibilities that existed at signature and have disappeared cannot be used to deprive an investor of the treaty protections. Incompatibilities that would arise after signature cannot be invoked either as states shall not have a unilateral right to reduce investment protection.

Russia also challenged the arbitral tribunal's jurisdiction to hear Yukos' claims because Yukos did not qualify as investor and its intra-group loans as investment under the ECT. These arguments failed as well.

Interpreting the terms "investment" and "investor," the FSC first noted that there are no unanimous definitions and then held that they shall be interpreted in good faith and in the light of the purpose of the treaty at issue: the ECT. The text of the ECT shows no intent by the contracting states to restrict the scope of these concepts. The definitions are broadly drafted and reflect the treaty's goal of stimulating and favoring investments in the energy sector. For the FSC an "investment" refers to any investment associated with an economic activity in the energy sector regardless of its form (payment, loan, etc.) or the origin of the funds. As for the investor, the FSC ruled that as owner or controller of the invested assets shall refer to their legal or beneficial owner. The FSC found that the arbitral tribunal correctly qualified the loans and Yukos as investment and investor respectively and there was no ground to limit or deny Yukos the protections available in the ECT.

The FSC also noted that the fact that the invested funds were channeled through a country designated for tax reasons is not incompatible with the purpose of the ECT; it is therefore not abusive and does not deprive the investor of its nationality and the rights associated with it. The objection of abuse of right is an exceptional remedy that cannot be readily accepted and in respect of treaty/nationality planning case, abuse only exists when a corporate restructuring is undertaken in connection with a foreseeable dispute and the investor cannot prove that it had other reasons to restructure (tax or other).

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II. Supplemental Swiss Rules for Corporate Law Disputes

Since 1 January 2023, Swiss corporate law expressly allows companies in Switzerland to include an arbitration clause in their articles of association (in French: *Statuts*; in German: *Statuten*). With the introduction of a new Article 697n in the Swiss Code of Obligations ("**SCO**"),[3] disputes relating to corporate relations are arbitrable and may be settled by an arbitral tribunal in Switzerland. These actions include challenges against decisions at the shareholders' meeting, requests for information and audit, petitions for the return of benefits, liability claims against board members, and applications for the dissolution of the company. Each company is free to limit the scope of arbitral corporate disputes and exclude certain types of disputes from arbitration. As with other arbitration clauses, the articles of association may regulate the arbitration proceedings, including by reference to institutional arbitration rules. Unless stated otherwise in the articles of association, once included, the arbitration clause becomes immediately binding on the company, its governing bodies, members of its governing bodies and the shareholders.

The legislative change prompted the Swiss Arbitration Centre to complement its existing Swiss Rules of International Arbitration and develop a '2023 Supplemental Swiss Rules for Corporate Law Disputes' (the "**Supplemental Rules**"). The Supplemental Rules are a short and pragmatic guide to ensure compliance with the statutory requirements and facilitate the efficient resolution of disputes in a fast-paced corporate environment. They cover the key elements of the arbitration of corporate disputes including the mandatory timely notification of the initiation and termination of arbitral proceedings to all potentially affected persons, the process of appointing the arbitral tribunal, the participation of third parties, information sharing over the course of the arbitral proceedings, and interim and emergency reliefs. One of the distinctive features of corporate disputes is that they may involve multiple parties. The notification requirement aims at allowing other interested persons to participate in the proceedings, including at the earliest stage and have a say in the appointment of the arbitral tribunal, or to obtain information and access the arbitration record for those whose interests might be affected by the outcome of the arbitration.

The Supplemental Rules came into force on 1 January 2023. If the arbitration clause in the articles of association refers to the Swiss Arbitration Centre, the Supplemental Rules will automatically apply in addition to the Swiss Rules of International Arbitration. This new tool is expected to assist companies in mitigating the negative impacts on the business of corporate law disputes by increasing their efficient resolution.

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Switzerland is a safe, arbitration-friendly and flexible forum for both investment and commercial arbitration.

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[1] Russia challenged the arbitral tribunal's jurisdiction on five grounds: (i) Russia never ratified the ECT and it only applied it provisionally in accordance with Article 45 of the ECT to the extent that such provisional application was compatible with the its Constitution, laws and regulations; (ii) the loans do not qualify as "investments" under the ECT; (iii) the dispute related to tax matters and is therefore excluded from the ECT's scope of application; (iv) Yukos Capital does not have substantial commercial activities and is owned by foreigners and therefore Russia is entitled to deny it investment protections; and (v) the investments were made illegally.

[2] 4A_492/2021 published on October 10, 2022.

[3] The application of Article 697n Swiss Code of Obligations is extended by references in Articles 764(2) and 797a Swiss Code of Obligations.