

Arbitration - Austria

Supreme Court defines limits of arbitration agreements

Contributed by **Graf & Pitkowitz Rechtsanwälte GmbH**

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The Supreme Court was recently faced with an inexecutable arbitration clause and took the opportunity to clarify the interpretation of arbitration agreements and their boundaries. The court held that arbitration agreements must be interpreted primarily under procedural law; however, if doubts arise under applicable contract law, or if an arbitration agreement refers to an arbitral institution which no longer exists, the agreement becomes inoperative only if it is impossible to reconstruct a comparable arbitration court.

Facts

The claimant owned a property subject to an easement in favour of the defendant. The easement contract, concluded in 1885, included an arbitration clause under which disputes were to be decided exclusively by an arbitration court established by the Engineers and Architects Associations in Vienna. This arbitration court no longer exists, and the current umbrella organisation for engineers and architects refused to deal with the matter. The parties were unable to present the arbitration rules last used by the association to the court.

The court was thus confronted with a situation where an arbitration agreement could not be executed within the meaning of Section 584(1) of the Code of Civil Procedure. According to this provision, a state court must deal with a matter subject to an arbitration agreement (apart from in cases where the defendant does not object) only if the court determines that the arbitration agreement no longer exists or cannot be executed.

The court of first instance decided that the arbitration agreement had been validly concluded under the then-applicable arbitration provisions of the 1781 General Court Procedures, which was later replaced by the Code of Civil Procedure. Therefore, the lower court concluded that the arbitration agreement could be executed.

The court of appeal reversed the court of first instance's decision, reasoning that an arbitration agreement which could originally be executed can, further down the line, become obsolete if it becomes objectively impossible to implement the agreed procedure on an *ex ante* (before the event) basis. Since the composition of the association's former arbitral tribunal, the appointment of the arbitrators or the content of the association's arbitration rules could not be determined, the court of appeal considered that a similar arbitral tribunal in accordance with the provisions of the Code of Civil Procedure could not be composed. For this reason, the court of appeal held that the arbitration agreement could not be executed.

Decision

The Supreme Court⁽¹⁾ initially noted that the principal issue at hand was not the effectiveness of the arbitration agreement, but its interpretation. The Supreme Court considered that since an arbitration agreement is primarily a procedural contract, procedural provisions must be first applied in order to interpret the agreement. If the procedural provisions are insufficient, the general interpretation rules of the Civil Code (Section 914) must be considered by analogy. If a court is unable to determine the parties' subjective agreement, it must interpret the wording of the arbitration clause based on a reasonable interpretation of the objective language that the parties used to express their intentions. If the language can reasonably be construed in more than one way, the court should favour the interpretation that upholds the validity of the arbitration

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agreement. However, courts are not permitted to construe an agreement that is not supported by the language that the parties actually used, and thus the furthest reaching literal sense constitutes the limit for any interpretation.

The Supreme Court added that a so-called supplemental interpretation under Austrian contract law can also be considered if subsequent events were not taken into account when concluding the arbitration agreement. Within that context, the following tools can be applied (in no specific order) according to the Supreme Court:

- the parties' hypothetical intention (had they considered the event);
- prevailing practice;
- the principle of good faith; and
- generally accepted standards.

When testing the 'functioning' of the arbitration clause with the parties' intention, the Supreme Court upheld the interpretation by the court of appeal, under which the parties would have wanted their dispute to be decided only by a comparable arbitral tribunal, but not by any ad hoc arbitral tribunal.

Furthermore, the Supreme Court also based the inability to execute on the consideration that the non-performance of the arbitration agreement should be allowed in cases only where effective legal protection could otherwise be endangered. In this context, the Supreme Court also considered Austrian and German literature and case law. It referred to cases where:

- an arbitral tribunal itself had declined jurisdiction;
- the institution had been dissolved without any replacement;
- the institution refused to administer the proceedings;
- an expressly agreed arbitrator was unable to perform the agreed arbitrator function; and
- one of the parties had faced financial difficulty.

The Supreme Court held that the arbitration agreement could not be executed because it was impossible to establish a similar arbitral tribunal parallel to the rules formerly agreed by the parties. It further held that any other interpretation would either be contrary to the intention of the arbitration clause or would deprive the claimant of its legal protection.

Comment

This decision has two noteworthy aspects. First, it gives a precise and conclusive understanding of how courts should interpret arbitration agreements. Second, it develops the meaning of the 'inability to execute' standard. In both aspects the Supreme Court continued – even expanded – its arbitration-friendly attitude, but still within clear limits.

Interpretation of arbitration agreements

The Supreme Court's analysis on interpretation of an arbitration agreement confirms and partially verbatim quotes prior case law, under which an arbitration agreement must be primarily interpreted under procedural laws, and only thereafter (secondarily) under applicable contract law (in the present case, the applicable provisions of the Civil Code). Since procedural law does not contain any explicit interpretation rules, the 'primary' interpretation method, in effect, mandates only the primacy of the literal wording, which, as the Supreme Court emphasised, must always constitute the limit for any interpretation.

In this decision, the secondary interpretation method was taken by the Supreme Court one step further than in prior decisions, since the instrument of supplemental contract interpretation was explicitly accepted as one permissible method to 'consider' when interpreting arbitration agreements. The Supreme Court's careful wording ('consider', not 'apply') becomes understandable when viewed with case law applying the instrument of supplemental contract interpretation in other circumstances. In fact, Austrian case law has bestowed on courts wide powers when applying this instrument generally to fill lacunas. Courts have even gone so far as to change the explicit wording of an agreement. The Supreme Court did not wish to go that far in the case at hand, but still accepted the primacy of the literal (procedural) interpretation. That is why it also explicitly tested the outcome against the wording of the arbitration clause.

When there is no lacuna, but two reasonable interpretations are possible, the Supreme Court confirmed the accepted rule – that the interpretation favouring arbitration should be applied.

For an international setting, particularly for contracts not governed by Austrian law, it is fair to conclude that the two-tier interpretation will necessarily lead to application of Austrian law in its first (primary) test under procedural law. As to the second test, the

interpretation of the applicable law will need to be established. However, again, given the primacy of Austrian procedural law, the furthest reaching literal understanding of the arbitration clause will most likely be seen as the limit for any foreign law interpretation.

The Supreme Court confirmed that the same interpretation rules must be applied when considering if a certain dispute falls with the scope of an arbitration agreement. It did not elaborate on that idea in this case, but it is worth noting that the Supreme Court has historically taken an arbitration-friendly approach. For example, the Supreme Court has already confirmed that an arbitration clause includes tort claims, provided that the circumstance on which the tort claim is based would also constitute a breach of the contract (double qualification test).

Even though the outcome of this decision may not please all practitioners, especially those seeking to expand arbitration agreements based on the 'group of companies' theory, it certainly establishes legal security and predictability.

Inability to execute arbitration agreements

When dealing with the question of when an arbitration agreement cannot be executed, the Supreme Court gave clear guidance on the issues to consider and the test to apply.

The Supreme Court, in essence, created a two-step test: beyond the need to establish that an arbitration clause is factually impossible to execute, it demanded that there was no possibility to substitute it by a comparable provision. In that respect, the decision takes an even more liberal approach than Austrian literature, which had already considered the first step – the mere non-existence of an arbitration institution – as sufficient to apply the inexecutability rule.

In the present case, since the arbitration clause was concluded more than 125 years ago, the parties had apparently failed to submit any specific evidence on the association's arbitration rules (possibly dating back even further). Therefore, the court could not establish a substitute tribunal to arbitrate based on the model of the former institution. In today's world of documentation and accessibility of data, it is hard to imagine that such a situation could ever re-occur. Therefore, even if an explicitly agreed institution should close its doors, as long as the parties can still submit evidence of its rules and procedures, the Supreme Court will likely uphold the arbitration agreement and mandate the decision by an ad hoc tribunal and proceed on the basis of the rules of that institution, as supplemented by the Code of Civil Procedure. That would lead courts to take on the role of institutional bodies which no longer exist (eg, for appointment and challenge of arbitrators), but still render the arbitration agreement capable of being performed.

Finally, the Supreme Court tested inability to execute in addition to, and apparently independently against, the right of a party to legal protection. This was not a disputed issue in the case, but could conceivably be an issue in the future. In an international setting it could be argued that the loss of an arbitration agreement could lead to a loss of legal protection, especially if the party then needed to resort to a national court unqualified to deal with that issue, or if it would be deprived of its right to rely on the New York Convention to enforce a decision.

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Endnotes

(1) Supreme Court decision, November 11 2011, docket no 3 Ob 191/11a.

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