Arbitration & ADR - Austria

Can a successfully challenged arbitrator be held liable for frustrated costs?

Contributed by **Graf & Pitkowitz**

November 27 2014

A recent Supreme Court decision analysed whether parties to arbitral proceedings are still bound to pay for part of an arbitrator's services where the arbitrator is successfully challenged because of his or her conduct.(1)

Facts

Mr K (not an attorney) was acting as president of the arbitral tribunal. In the course of the proceedings, the claimant brought a challenge against K. The challenge succeeded and K was removed by court decision.(2) When K stepped down, the proceedings had not yet been concluded and no award had been rendered. After the arbitral proceedings ended (under a new presiding arbitrator), the claimant filed a claim against K with the state court requesting damages.

The parties had agreed on *ad hoc* fast-track proceedings, which were to be concluded within six months. The presiding arbitrator, K, apparently conducted somewhat informal and direct communications. The reason for the challenge was not specifically addressed in the decision; however, it mentioned the following events:

- During the process of appointing an expert, K received two preliminary reports from an expert candidate.
- While K had disclosed to the parties his correspondence with the expert candidate and the second report, he failed to disclose the first report, which contained an informal opinion from the expert.

The claimant alleged that K had grossly and culpably infringed his duties by improperly influencing the appointment of an expert and in that context had:

- manipulated email correspondence;
- manipulated the basis for the co-arbitrators' decisions; and
- withheld information.

The claimant alleged that it had incurred damages due to K's unlawful and culpable conduct as arbitrator and president of the tribunal and thus claimed damages for legal fees, cost advances, arbitrators' fees and costs for a party-appointed expert. In addition, the claimant held that K had no claim to receive arbitrators' fees and that he should return the portion that he had received. Altogether, the claimant requested more than €1.4 million in damages.

The *ad hoc* arbitration agreement did not refer to the consequences of a successful challenge. However, the arbitrator agreement provided for a limitation of liability for all of the arbitrators. Liability was limited to the cost of the arbitrators' fees and to cases of blatant gross negligence and intent. The claimant argued that the limitations of liability did not apply, as no arbitral award was rendered at the time of the challenge and because it was *contra bonos mores* (ie, against good morals).

First and second-instance decisions

The court of first instance stated that the arbitrator's contract was a contract for services, coupled with elements of an agency contract. It observed that K had already:

- prepared for the arbitral proceedings;
- familiarised himself with the case;
- studied the pleadings and documents filed by the parties;
- prepared questions for experts;
- selected and appointed an expert;
- prepared and held the hearing; and
- prepared the award.

As a result, the court held that these works justified the payment of half of K's remuneration. Therefore, the fee already paid (one-quarter of the remuneration agreed) was not to be reduced. The court of first instance further dismissed the claimant's claim for damages because K's liability was contractually limited to blatant gross negligence and intent.

The court held that while K had failed to disclose the first preliminary expert report, he had nevertheless disclosed the second and had otherwise clarified the views of the expert before the expert was appointed. It was thus clear which views the expert held. The court held that it was legitimate to confirm the expertise of the possible expert, particularly when considering the complexity and short duration of the arbitral proceedings. The court thus concluded that discussions between arbitral tribunals and expert candidates concerning the content of a dispute before the appointment of an expert are generally not prohibited.

In addition, the parties had an opportunity to question the expert during a hearing held after the expert's opinion was issued. The court also observed that K's general negative remarks about the claimant and its attorney, although not honourable, did not amount to gross negligence, particularly due to the informal style of communications between K and the expert candidates. Because of this, the court of first instance ruled that K was not blatantly or grossly negligent.

The appellate court agreed that the claimant was not entitled to claim damages, but reversed part of the court of first instance's decision and ruled that K had to reimburse the portion of the arbitrator's fee that he had received. According to the court, the successful challenge against K before the Vienna Commercial Court was binding only insofar as it confirmed that there were justified doubts as to K's impartiality and independence.

The appellate court reasoned that parties generally have no interest in carrying out arbitral proceedings without resolving the dispute. K could no longer render an arbitral award and the circumstances leading to his inability to do so – in particular, the manner in which K performed the arbitral proceedings – were due to his conduct. Therefore, the court ordered K to return the portion of the arbitrator's fee that he had received. Further, the court held that K could not rely on Section 1168(1) of the Civil Code, which provides that if the performance of the work remains undone, the agreed remuneration is still due to the contractor (ie, K) if he or she has been prevented by circumstances attributable to the purchaser (ie, the parties to the arbitral proceedings).

Supreme Court decision

The Supreme Court restored the judgment of the court of first instance and entirely dismissed the claim.

While the Supreme Court confirmed that the binding effect of the challenge decision prevented it from assessing whether K had in fact been biased, the question of whether damages arose from the conduct had to be decided independently.(3)

The Supreme Court also referred to case law which highlighted the fact that an arbitrator's liability requires, as a precondition, that the arbitral award be successfully set aside. If an error does not result in the setting aside of the award, the arbitrator cannot be liable for such errors.(4) However, the court held that it was not required to consider this case law, as the liability of the arbitrator had already been denied.

The Supreme Court opposed the claimant's argument that the contractual exclusion of liability covered only the arbitral award as the end product of the arbitral proceedings. Rather, the court held that, pursuant to Section 914 of the Civil Code,(5) reasonable parties would not agree for liability to be limited to the arbitral award, but would instead stipulate that the entire arbitral proceedings should fall within this

exclusion. Otherwise, an arbitrator conducting arbitral proceedings would continuously have to fear that any misconduct on his or her part would result in an unforeseeable claim for damages.

The Supreme Court noted that the parties to the arbitrator's contract had agreed only on the arbitrator's fee for the overall work (ie, conducting the proceedings and rendering the award). Therefore, no agreement had been established regarding a premature termination of the contract. In the court's view, this gap had to be filled by means of a supplementary interpretation of the contract. The Supreme Court pointed out that remuneration is generally due to arbitrators, even where there are shortcomings in the course of the arbitral proceedings or the arbitral award is set aside. In this light, it was to be assumed that fair and reasonable parties that had agreed to remunerate the arbitrators for their overall performance would not agree to deny remuneration because of an early termination of the contract, but rather to reduce the fee in relation to the services already rendered.

The court found that it had not been established that K's services had been worthless. Therefore, the above interpretation regarding the total or partial worthlessness of an arbitrator's services was irrelevant and thus was not addressed.

Comment

This decision addresses specific aspects of arbitrators' liability. Further, it is in line with Austrian case law, which takes a restrictive approach and considers the entirety of circumstances. The courts gave adequate weight to the fact that while the presiding arbitrator had apparently not fully informed the parties of his correspondence with the expert candidate, he had in essence provided them with sufficient information to assess the situation. In addition, the arbitration's short timeframe was taken into consideration.

The Supreme Court left two issues partially unanswered. First, the Supreme Court has repeatedly requested that awards be set aside as a precondition to arbitrators' liability.(6) The Supreme Court only briefly addressed whether this rule also applies in a case where – as here – an arbitrator is successfully challenged before rendering the award. It held that it "need not scrutinise this issue closer", as liability had been denied. Nevertheless, the Supreme Court should have clarified that liability may also arise independently of the setting aside of an award. There is no reason to limit arbitrators' liability to cases where the annulment of the award succeeded. The rationale behind this case law is to prevent a party from achieving, via a liability claim, what it could not achieve by challenging the award. However, there are other cases where this rational is not at issue and liability is still triggered.

Second, the Supreme Court left open – due to lack of relevance – the question of whether the remuneration for arbitrators' services would be due if the services were considered totally worthless. The answer to this question is somewhat complex, as it was held that the arbitrator's contract was a contract for services coupled with elements of an agency contract. Depending on whether the remuneration is dealt with under the principles of contracts for services (regulated in Section 1165 *et seq* of the Civil Code) or agency contracts (Section 1002 *et seq* of the Civil Code), an arbitrator may or may not have an obligation to return the portion of remuneration that he or she already received. The only common principle behind both regimes is that if the work is found to be worthless, the arbitrator will receive no remuneration.

Under the regulations for contracts for services (in particular, Section 1168(1) of the Civil Code), if the performance of the work remains uncompleted, the agreed remuneration is still due to the contractor (ie, the arbitrator) if he or she has been prevented from completing the work by circumstances attributed to the purchaser (ie, the parties to the arbitration). In the opposite case, when the work is uncompleted for reasons attributable to the contractor, no remuneration is due. If the contract was qualified as an agency contract and the principal (ie, the parties to the arbitration) terminated the contract, it must reimburse the agent (ie, the arbitrator) for the costs incurred up to the termination of the agreement and afford a reasonable part of the agreed fee, considering all of the services which were supposed to be rendered under the agency contract and those that were actually rendered.(7) This also applies where a lump-sum fee has been agreed.(8) However, no remuneration is due if the agent's services are determined to be worthless, considering the agreement's goal.(9)

For further information on this topic please contact Nikolaus Pitkowitz at Graf & Pitkowitz by telephone (+43 1 401 17 0), fax (+43 1 401 17 40) or email (pitkowitz@gpp.at). The Graf & Pitkowitz website can be accessed at www.gpp.at.

Endnotes

(1) 4 Ob 197/13v.

(2) See the Vienna Commercial Court decision dated April 21 2011 (17 Nc 10/10h).

(3) This is in line with the Supreme Court decision dated October 7 1992 (1 Ob 3/92) discussing state liability for costs of nullified court proceedings due to a judge's bias.

(4) This has been held in the Supreme Court decisions dated June 6 2005 (9 Ob 126/04a) and February 28 2008 (8 Ob 4/08h).

(5) "When interpreting contracts, one shall not adhere to the literal meaning of an expression but has to determine the intention of the parties and the contract to be understood in line with due commercial practice."

(6) The Supreme Court repeatedly asked for this requirement (see, eg, the Supreme Court decision dated October 17 1928 and judgments under note 4).

(7) *Strasser* in *Rummel*, ABGB, § 1026 Rn 8.

(8) *Id*.

(9) Supreme Court decision dated May 3 1979, (7 Ob 621/79, SZ 52/73).

Author

Nikolaus Pitkowitz