Arbitrators, don't overdo it without involving the parties!

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RÉFÉRENCES :

– C. Cass., 1st Civ. Ch., 29 June 2011, n° 10-23321, *Overseas Mining Investment Ltd v. Commercial Caribbean Nickel* – F-P+B+I

RÉSUMÉ

Une sentence allouant des dommages-intérêts pour la perte de chance de réaliser des gains futurs, au lieu des gains manqués attendus, comme le réclamait le demandeur, risque l'annulation devant les juridictions françaises, pour non respect du principe de la contradiction, s'il apparaît que les arbitres ont modifié le fondement de la demande sans inviter les parties à s'expliquer sur ce point. Le contrôle des sentences s'attachant davantage à la forme qu'au fond, l'on ne saurait s'étonner de l'inflation récente des recours fondés sur le grief d'une violation du contradictoire. Le présent commentaire s'interroge sur cette tendance qui pourrait bien, en définitive, ne pas servir la qualité de la justice arbitrale.

ABSTRACT

An award for damages covering the lost chance of making profits in the future, instead of damages for the loss of expected profits as requested by the claimant, risks being set aside by French courts for denial of due process if the arbitrators appear to have modified the basis for compensation without having invited the parties' comments on this issue. Judicial control being increasingly on form rather than on substance, the recent inflation of challenges based on due process considerations is not surprising. This note questions a trend which may not ultimately serve the quality of arbitral justice.

In 1998, Commercial Caribbean Nickel (CCN, a Cuban company) and Overseas Mining Investments Ltd (OMI, a company incorporated in Jersey) entered into a joint-venture agreement with a view to mining nickel deposits in Cuba. CCN terminated the agreement in 2004. Pursuant to the arbitration clause contained in the parties' agreement, OMI brought an arbitration under the UNCITRAL rules. The arbitral

tribunal, composed of Messrs. Grigera Naon (Chairman), Paulsson and de Cossio Rodriguez, ordered CCN to pay OMI a principal amount of more than USD 45 million in damages for wrongful termination and other breaches of the parties' agreement by CCN, in an arbitral award issued in Paris in 2008.

CCN applied to the Paris Court of Appeal for the setting aside of the award on various grounds, alleging in particular that the arbitral tribunal denied it due process by awarding damages based on the loss of a chance to pursue the mining project, whereas OMI had brought a claim for lost profits expected from the said project, and the question of OMI's lost chance had not been discussed during the arbitration.

By judgment of 25 March 2010, the Court of Appeal agreed with CCN on this point and set aside the arbitral award. [1] OMI brought the matter before the Court of Cassation.

On 29 June 2011, the Court of Cassation held that the Court of Appeal "accurately noted that, in their reasoning, the arbitrators had substituted the compensation based on lost profits claimed by OMI, which they considered inadequate, with compensation based on the loss of the chance to see the project materialize, which OMI did not raise, and that this substitution was not a mere method for evaluating the damage but modified the basis for OMI's compensation ; that the Court of Appeal rightly concluded from the foregoing that in failing to invite the parties' comments on this issue, the arbitrators breached due process". [2]

In France as in many civil law systems, the traditional view is that, while the parties have the task to allege and prove the facts, it is the judge's power and duty to apply the law. However, in reality, even before state courts, the allocation of responsibilities is no longer as clear-cut. [3] Although an arbitrator, especially in international cases, never stands in the same position as a judge when it comes to his duty to apply the law, [4] the rule remains that, unless they have been empowered to rule *ex aequo et bono*, arbitrators have a duty to settle the dispute "in accordance with the law" (in domestic cases) [5] or "in accordance with the rules of law" (in international arbitrations). [6] The effectiveness of this duty may well be questioned, as there is no mechanism to ensure

1. Paris CA, 25 March 2010, Commercial Caribbean Nickel v. Overseas Mining Investment Ltd, RTD com. 2010.545, obs. E. Loquin ; Rev. arb. 2011.442, n. C. Chainais ; Mealey's Int'l Arbitration Report, Vol. 25, June 2010, n. D. Bensaude and J. Kirby ; JCP G 2010.644, obs. Ch. Seraglini.

2. C. Cass., 1st Civ., 29 June 2010, n° 10-23321, Overseas Mining Investment Ltd. V. Commercial Carribean Nickel, Procédures 2011.307, n. L. Weiller ; Rev. arb. 2011.678, n. C. Chainais ; LPA 2011 n° 227, p.9, n. Th. Clay ; Gaz. Pal. 2011 n° 315, p.12, n. D. Bensaude ; D. 2011.1911, obs. X. Delpech.

3. Particularly following the decisions issued by the Court of Cassation's Plenary Assembly on 7 July 2006 (n° 04-10672, Bull. ass. plén., n° 8) and 21 December 2007 (n° 06-11343, Bull. ass. plén., n° 101).

4. P. Mayer, "Reflections on the international arbitrator's duty to apply the law", in *Arbitration Insights : Twenty Years of the Annual Lecture of the School of International Arbitration*, J.D.M. Lew and L.A. Mistelis ed., Kluwer Law International, 2007, p.289.

5. Article 1478 of the French Code of Civil Procedure (CCP). See also Article 1464 §2 CCP, which makes Article 12 §2-3 CCP applicable to domestic arbitration (Article 12 CCP is one of the "guiding principles for trial". Paragraphs 2 and 3 relate to the judge's duty to properly characterize the facts under the law, except where the parties have expressly agreed on a legal characterization in respect of rights they can freely dispose of). Interestingly, before this year's reform of French arbitration law (Decree n° 2011-48 of 13 january 2011), Article 12 was not referred to as a principle applicable to arbitration.

6. Article 1511 CCP.

that the arbitral tribunal indeed correctly applied the law. [7] Nevertheless, depending on their own legal background and personal vision of their mission, arbitrators may feel that they ought to redress a flawed legal characterization advanced by one party, modify *ex officio* the legal basis for a claim, or raise *sua sponte* a legal issue they consider decisive or important for a proper adjudication of the case.

Under French law, arbitrators are allowed to raise points of law *ex officio*, both in domestic and international cases. The limits and conditions to the exercise of this power are not easy to define. Combined with the risk that the arbitrators' initiative be perceived as a sign of partiality, as it almost unavoidably improves one party's case, they make it a delicate, if not perilous task.

First of all, arbitrators do not have the power to modify the subject-matter of the dispute brought before them by the parties. [8] Should the arbitral tribunal rule on a claim that was not made by any party (*ultra petita*), it would violate the mandate conferred upon it, which is a ground for setting aside or denying enforcement of the award, [9] irrespective of due process requirements. Accordingly, when modifying the legal basis for a claim, arbitrators have to be careful not to thereby introduce a different claim.

In *Caribbean Nickel*, the Court of Cassation (following the Court of Appeal's analysis) considered that, by compensating OMI for a lost chance of seeing the project through, rather than for the lost profits expected from the project, the arbitrators substituted a different basis for OMI's claim for compensation. However, if the lost chance of making profits really were something different from the loss of expected profits, as stated in the *Caribbean Nickel* award and court decisions, it seems that the problem could properly have been raised in terms of *ultra petita*. The subject-matter of a claim for damages is not only to obtain monetary compensation. It is to obtain monetary compensation for a certain given damage.

In addition, under French arbitration law, the immediate corollary of the arbitrators' faculty to raise legal issues *ex officio* is their obligation to invite the parties to comment on any legal issue so raised by them. [10] This obligation is one of the essential components of due process, and violation of due process is a ground for setting aside or refusing enforcement of arbitral awards. [11] The purpose is that nothing in the arbitral award should take the parties, or any of them, "by surprise." [12] In other

7. The only limit, in international arbitration, is that the recognition or enforcement of the award must not be contrary to international public policy (Article 1520-5° CCP), the review being limited to a "flagrant, effective and concrete" violation of international public policy (C. Cass., 1st Civ., 4 June 2008, SNF v. Cytec industries, n° 06-15320, Bull. I, n° 162).

8. This rule is known in French civil procedure as the *principe dispositif*, embodied in Article 4 ("The subject-matter of the dispute is determined by the respective claims of the parties. [...]") and Article 5 CCP ("The judge must rule upon all what is claimed and only upon what is claimed").

9. Articles 1492-3° and 1520-3° CCP.

10. G. Bolard, « Les principles directeurs du procès arbitral », Rev. arb. 2004.511 ; For a recent synthesis on the subject, see C. Chainais, « L'arbitre, le droit et la contradiction : l'office du juge arbitral à la recherche de son point d'équilibre », Rev. arb. 2010.3. See also A. Carlevaris, « L'arbitre international entre Charybde et Scylla : le principe *jura novit curia* entre le principe de la contradiction et impartialité de l'arbitre », Paris Journal of Int'l Arb. 2010.433 ; A. Dimolitsa, « The equivocal power of the arbitrators to introduce *ex officio* new issues of law », ASA Bull. 2009.426.

11. Articles 1492-4° and 1520-4° CCP.

12. C. Kessedjian, « Principe de la contradiction et arbitrage », Rev. arb. 1995.381, spec. p. 408. See also the International Law Association's Recommendations on Ascertaining the Contents of the

civil law systems, in particular under Swiss law, the arbitrators' duty to apply the law does not necessarily imply that the parties be consulted specifically on legal issues raised by them *ex officio*. As the Swiss Federal Court regularly asserts, it is only "in exceptional circumstances" that the parties have the right to be heard, where the tribunal intends to base its decision on a legal provision or a legal theory that none of them had relied upon and the application of which would take them by surprise. [13] A judgment of the Finnish Supreme Court is often cited to the same effect. [14]

It is however also commonly admitted, and repeatedly affirmed by French courts, that the arbitrators are not obliged to submit to the parties' debate the legal reasoning leading to their decision, as long as this reasoning is based on factual and legal elements that the parties have discussed, or have had a reasonable chance to discuss [15]. A line therefore needs to be drawn between what constitutes a legal ground for the decision (which must be raised by or with the parties) and what belongs to the arbitral tribunal's legal reasoning (which does not need to be discussed with the parties).

In a series of recent decisions, largely approved by legal commentators, the Paris Court of Appeal and the Court of Cassation have moved this line to reinforce the arbitrators' duty to submit to the parties the legal issues raised by them. For example, it is now clear that, where the arbitral tribunal intends to ground its award on certain provisions of the law chosen by the parties to govern the contract which have not been specifically relied upon by any party, due process requires that the parties be given the opportunity to discuss the said provisions and their application to the case. [16] This solution shows a clear shift towards greater severity when compared to previous case-law. [17]

In the past, arbitral awards have been validated in cases where the arbitral tribunal had failed to invite the parties' comments before referring to a broadly recognized

Applicable Law in International Commercial Arbitration adopted in Rio de Janeiro in August 2008, spec. Recommendation n° 8 (www.ila-hq.org/en/committees/index.cfm/cid/19).

13. See for example Swiss Fed. Trib., 3 August 2010, ASA Bull. 2010.803, 9 February 2009, ASA Bull. 2009.495, 19 February 2007, ASA Bull. 2009.501.

14. Finnish Supreme Court, case S2006/716, 2 July 2008, referred to by S. Nappert, "Arbitral Activism: the Manifold Guises of Jura Novit Arbiter", Paris Journal of Int'l Arb. 2010.125, who contrasts it with the decisions of the Quebec Superior Court of 8 December 2008, Dreyfus v. Holding Tusculum.

15. See for example Paris C.A, 19 September 2002, SA Fach v. Epx Martinval, Rev. arb. 2004.619, n. G. Bolard ; 2 March 2006, Fashion Box Group S.P.A.v. A.J. Heelstone LLC, Rev. arb. 2006.733 ; 29 November 2007, Leng d'Or v. Pavan S.P.A., Juris-Data n° 2007-354020 ; 14 May 2009, Colombet v. Gomez, Juris-Data n° 2009-378253.

16. Paris CA, 3 December 2009, Engel Austria GmbH v. Don Trade et al., JCP G 2010.644, obs. Ch. Seraglini, Rev. arb. 2010.105, n. C. Chainais, Paris Journal of Int'l Arb. 2010.433, n. Andrea Carlevaris ; Paris CA, 19 June 2008, Arab Republic of Egypt v. Malicorp, Rev. arb. 2010.105, n. C. Chainais, upheld by C. Cass., 1st Civ. Ch., 23 June 2010, n° 08-16858 and 09-12399, Rev. arb. 2010.674 ; C. Cass., 1st Civ. Ch., 14 March 2006, n° 03-19764, Conselho Nacional de Carregadores v. Charasse, Rev. arb. 2006.653, n. G. Bolard ; JCP E 2006.2260, comm. M. Danis. The Court of Cassation accepted however to uphold an arbitral award in which a legal issue raised *ex officio* by the tribunal without inviting the parties' comments was used only as an *obiter dictum*. See C. Cass., 1st Civ. Ch., 6 May 2009, n° 07-20345, Ciech v. Comexport Companhia Exterior, Rev. arb. 2010.90, n. C. Chainais.

17. When it was held that parties could not complain if the arbitral tribunal complied with their duty to apply a certain law chosen by the parties, even if they had applied rules of that law that the parties had not mentioned in their submissions : Paris CA, 28 May 1993, Société Générale pour l'Industrie v. Ewbank and Partners Ltd, Rev. arb. 1993.664, n. D. Bureau, upheld by C. Cass., 1st Civ., 28 February 1995, n° 93-18486, Rev. arb. 1995.597, n. D. Bureau.

legal principle belonging to the body of law chosen by the parties. For example, in an international arbitration in which French law was applicable to the merits, no denial of due process was found where the tribunal applied the general principle of good faith in contractual relationships (Article 1134 of the Civil Code) without prior consultation with the parties. [18] Similarly, no denial of due process was found in domestic cases in which the arbitral tribunal applied the Civil Code's general precepts relating to the interpretation of contracts. [19] It is doubtful however whether such tolerant solution would still be valid today.

By setting aside the award for denial of due process in *Caribbean Nickel* because compensation was awarded on the basis of the loss of chance theory whereas the parties had discussed a claim for loss of profits, the commented decision clearly belongs to the recent line of cases imposing a very high standard of transparency on arbitrators as to the legal substructure on which they set up their decision. [20]

Quite strikingly, the solution appears to be the opposite in judicial proceedings : there is no violation of due process when trial judges limit the claim to the lost chance of making a gain or avoiding a loss without inviting the parties' comments on this issue. [21] In a recent case, the Court of Cassation even seems to have permitted the trial judge to substitute the compensation for a lost chance of avoiding a damage of a different nature than the damage for which compensation was sought. [22] Ms. X, who had taken a loan to finance the purchase of a property, became disabled. Having realized that the insurance policy covered only the risk of death, but excluded the risk of disability, she sued the finance company for the breach of its duty to provide proper advice and claimed damages in the amount of the outstanding scheduled payments under the loan agreement. The trial judges held that the finance company had indeed breached its professional duty to provide full and proper advice, but they considered that Ms. X' damages should be limited to the compensation for the lost chance of the possibility to find a more protective insurance coverage at an acceptable cost when taking the loan. The Court of Cassation held that the trial court, "ruling on claims and factual elements which were on the record [...], did not disregard the subject-matter of the dispute or due process when it considered that the damage caused by the breach constituted a lost chance which it had full discretion to evaluate".

In *Caribbean Nickel,* the lost chance against which the arbitrators have evaluated the compensation is the lost chance of making the very profits for the loss of which

18. Paris C.A., 25 november 1993, Paco Rabanne Parfums and Paco Rabanne v. Les Maisons Paco Rabanne, Rev. arb. 1994.730, n. D. Bureau.

19. Paris C.A., 25 March 1993, Cacharel v. Vestra Groupe, and 28 May 1993, Romak v. Philip Marine, Rev. arb. 1995.468, n. C. Kessedjian.

20. Before Caribbean Nickel, in a case involving a domestic *ex aequo et bono* arbitration, the arbitral award was also set aside on the grounds that the parties had been denied due process for not having had the possibility to discuss the loss of chance theory used by the arbitral tribunal in their decision : Paris CA, 15 May 2008, Atac v. Crisinvest, D. 2010.2933 confirmed by C. Cass., 1st civ. ch., 1st July 2009, n° 08-17721.

21. C. Cass., 1st cv. ch., 30 October 2007, n° 06.16300 ; 15 May 2007, n° 04-15744 ; C. Cass. Comm. Ch., 24 January 2006, n° 05-10564 ; 14 June 2005, n° 02-15127 ; 26 October 1999, n° 96-10467. See also : C. Cass., 3rd Civ. Ch., 27 October 2009, n° 08-17246.

22. C. Cass., 1st Civ. Ch., 18 September 2008, n° 06-17859, Bull. I, n° 204. Two months later, however, the same chamber of the Court of Cassation seems to have adopted the exact opposite solution : C. Cass., 1st Civ. Ch., 13 November 2008, n° 07-18101, Bull. I, n° 257.

OMI had brought a claim against CCN. The lost chance for which the arbitrators accepted to compensate OMI in their award is but a fraction of OMI's total claim for lost profits, the fraction that the tribunal considered had a sufficiently certain causal link with CCN's contractual breaches.

In every case involving a forgone business venture which never saw the light, any calculation of loss-of-profit damages is necessarily speculative. It is often impossible to state with certainty that, had there been no breach of contract, the project would have turned into the full amount of the expected profits. [23] The success of the Cuban nickel mining project probably depended, not only on the proper performance of the parties' contractual obligations, but also on more or less hypothetical circumstances involving third parties (such as governmental or administrative authorizations). Whereas OMI's best interest was to claim 100% of the expected profits, particularly as CCN apparently did not object that a chance factor had to be applied, the tribunal was most probably right in discounting OMI's claim, so as to reflect the chance of OMI never receiving such profits. Such discounts on claims for projected profits to account for the project's chance of success are routinely applied by international arbitration tribunals without it crossing anyone's mind that the basis for the claim is thereby modified.

In this case however, based on the excerpts of the award quoted in the Court of Appeal decision, the arbitral tribunal itself seems to have presented the application of the loss of chance theory as something totally different from the compensation criteria advanced by OMI to support its claim for the lost expected profits. The tribunal noted that "the potential financial profit which was lost cannot be assessed with certainty, but the chance to collect it can indisputably be valued", and emphatically stated that damages for lost chance are "not the same" as damages for lost profits.

A more modest approach – simply stating, for example, that the direct causal link of OMI's claim with the breach had been established only up to X% in view of the uncertainties affecting the success of the project – would probably have avoided the setting aside of the arbitrators' award on this ground, provided, as is most likely, the chances of success (or the uncertainties) of the project had in fact been discussed during the arbitration proceedings and were therefore part of the records on the basis of which the arbitrators reached their decision. [24]

The stated grounds for the arbitrators' decision in this case may not have left much choice for the French courts but to set aside the award, in view of the very formal nature of the review they exercise when ruling on an application to set aside or to refuse enforcement of arbitral awards. Out of fear of looking more closely at what the arbitral tribunal actually decided based on what it actually had on the records – and of thereby

23. As noted in the comment under Art. 7.4.2(2) UNIDROIT Principles 2004, "The loss of profit or, as it is sometimes called, consequential loss, is the benefit which would normally have accrued to the aggrieved party if the contract had been properly performed. The benefit will often be uncertain so that it will frequently take the form of the loss of a chance."

24. The risk factor involved in this venture most probably explains why the counterclaim made by CCN in the arbitration was a claim for the loss of a chance. Considered as irrelevant by the Paris Court of Appeal, the loss-of-chance nature of CCN's counterclaim might however have shown that the uncertainties affecting the outcome of the project had actually been discussed before the arbitral tribunal.

committing the capital sin of "reviewing the merits" of the award – the French courts annulled the award because "in their reasoning", [25] the arbitrators substituted compensation for lost profits with compensation for a lost chance without inviting the parties' comments.

The result is paradoxical because for the purpose of the French courts' control over arbitral awards, the arbitrators' "reasoning" is otherwise strikingly irrelevant. Provided they formally exist, [26] the reasons for the award may well violate the applicable law, contradict each other, or contradict the actual decision, it does not matter for the validity and enforceability of the award. [27] Why in *Caribbean Nickel* should the arbitrators' "reasoning" (as partially quoted by the French courts), and the theory stated therein about the loss of expected profits being ontologically different from the loss of a chance of making these profits, provide a sufficient basis to justify the setting aside of the award for denial of due process? Should the Court of Appeal not have checked, instead, that the factual basis for the decision, in particular the uncertainties affecting the success of the venture, had in fact been discussed during the arbitration proceedings, so that discounted damages could perfectly have been awarded without any due process violation?

The lesson to be drawn from *Caribbean Nickel* and the case-law trend to which it belongs may appear to be that arbitrators would be well advised to submit every components of their legal reasoning to the parties' discussion. Such an approach would however often be impracticable and is hardly compatible with the jurisdictional function of the arbitral tribunal. Special care is nevertheless needed when setting down the reasons for the award. Whenever an idea that has not evidently been discussed in the parties' submissions is brought up in the arbitrators' deliberations and in the motivation of the award, caution requires inviting the parties' comments.

From the point of view of judicial control, intransigence on compliance with due process requirements is of course an important safeguard for the quality of arbitral justice, but the control should not be purely formal. In *Caribbean Nickel*, it would have required looking beyond the arbitrators' "reasoning" relating to the loss-of-chance theory, to see if the chance factor justifying the discounted damages had not in fact been discussed by the parties so that the arbitrators could use it in their damages assessment. In the affirmative, the award (which, on the merits, reached a probably better solution than if it had granted OMI 100% of its claim, or if it had dismissed it entirely as too uncertain to be compensable) deserved to be upheld despite the arbitrators' somewhat unfortunate "reasoning" on the loss-of-chance theory.

"Not only must justice be done, it must also be seen to be done", [28] but arbitration would no longer be justice if it needed only be "justice seen to be done" to pass judicial control.

25. This is a quote of both the Paris Court of Appeal and the Court of Cassation's decisions in Caribbean Nickel.

26. Unless, in international cases, the parties have exempted the arbitral tribunal from the duty to state reasons for the award.

27. C. Cass., 1st Civ., 11 May 1999, nº 95-18190, Rivers v. Fiorucci, Rev. arb. 1999.811, n. E. Gaillard ; RTD com. 2000.336, obs. E. Loquin.

28. Lord Hewart CJ in R. v. Sussex Justices, ex parte McCarty ([1924] 1 KB 256, [1923] All ER 233).