

Vladimir Pavić

## COUNTERCLAIM AND SET-OFF IN INTERNATIONAL COMMERCIAL ARBITRATION\*

*Until recently, admissibility of counterclaims before international commercial arbitrations has been treated in accordance with a relatively simple formula – one had to ascertain the objective scope of the arbitration agreement. With regard to set-off defense, however, admissibility threshold was less clear and mostly dependent on the relation between the main claim and the claim used for purpose of set-off. The newly promulgated Swiss Arbitration Rules have, for the first time, enabled a potential broadening of arbitral jurisdiction over set-off claims, enabling Swiss tribunals to adjudicate even those set-offs already subject to another arbitration clause or forum selection clause. This might lead to a potentially dangerous situation, where such attraction of jurisdiction might lead to a conflict with another tribunal or court expressly designated as competent with regard to relations giving rise to a set-off. This triggers later dilemmas with regard to the reach of decisions on set-off and the possibility that the tribunal applies the lis pendens rules in order to avoid conflicting decisions.*

Keywords: *Arbitration. – Counterclaim. – Set-off. – Jurisdiction. – Lis pendens. – Res judicata.*

It has been more than twenty years since Professor Poznić analyzed, in this very periodical, the problems posed by counterclaim in arbitral proceedings.<sup>1</sup> Ten years afterwards, he again addressed this issue, treating the objective scope of arbitration agreement.<sup>2</sup> Given the plethora of legal writing dealing with problems of arbitration and civil procedure, one is almost surprised at the scarcity of papers addressing these issues.

---

\* The Author wishes to express his gratitude to Professors Gaso Knezevic and Tibor Varady, who have provided valuable comments on earlier drafts of this paper.

1 Poznić B. “Protivtužba u arbitražnom sporu”, *Anali Pravnog fakulteta* vol. 3–4, 421–425.

2 Poznić, B. “Granice arbitražnog sporazuma”, *Pravni život* vol.11–12–1993, 1821–1840.

Now and then they are treated separately, or sporadically they are examined within the broader issue of objective reach of arbitration agreements. In any case, recent adoption of Swiss Arbitration Rules have spurred new interest with regard to admissibility and reach of counterclaim and set-off in international commercial arbitration.

This paper will try to analyze and, where possible, shed light on several issues. Firstly, the very notions of counterclaim and set-off, as well as their differentiation before international commercial arbitration. Secondly, the issue of objective scope of arbitration agreements with regard to counterclaims and set-offs. Finally, this paper will try to examine certain policy outcomes stemming from explicit treatment of set-offs and counterclaims (as has been done in newly adopted Swiss Arbitration Rules).

## 1. COUNTERCLAIM AND SET-OFF

### 1.1. Counterclaim and set-off in litigation

When facing a claim before an arbitral tribunal, the defendant has three options at his disposal. One is, naturally, to deny the claimant's allegations. The other, a more 'offensive' tactic, would be to submit a counterclaim, and the third, a 'defensive' option, to raise a set-off defense. The same is also applicable in litigation. Comparative systems of civil procedure clearly distinguish between the counterclaim (*Widerklage*, *demande reconventionnelle*, *domanda riconvenzionale*) and the set-off defense (*Processaufrechnung* (*Verrechnung* in Switzerland), *compensazione legale*, *eccezione di compensazione*).<sup>3</sup>

In domestic litigation, the defendant may submit a counterclaim until the conclusion of the main hearing; however, she may do so only if the counterclaim is related to the main claim. In addition, the two claims must either be capable of being compensated against each other, or, alternatively, the counterclaim has to be submitted in order to determine

---

<sup>3</sup> European Court of Justice clearly distinguished between counterclaim and set-off in the case of *Danvaern Production A/S v. Schuhfabriken Otterbeck GmbH & Co.* C-341-93. Perhaps the only country where this distinction has been blurred is the United States, where set-off defence is omitted from the federal rules of procedure. However, this neither means that U.S. courts treat counterclaims and set-offs equally, nor that one may raise claims that have no connection whatsoever to the original cause of action. (Federal Rules of Civil Procedure, 13 (a-b), Wright, C., Miller A.: "Federal Practice and Procedure: Federal Rules of Civil Procedure Vol. 6", 2. ed, St. Paul, 1990, p. 1426.; *Inter-State National Bank v. Luther* 221 F.2d 382 (10th Cir. 1955), with certain reservations with regard to subject-matter jurisdiction, *Federman v. Empire Fire & Marine Insurance Co.* 597 F.2d 798 (2nd Cir. 1979).

the (non)existence of a right or legal relationship vital for the outcome of the main claim.<sup>4</sup> Therefore, there are three types of counterclaims: connected (to the main claim of the claimant), compensatory (designed to compensate mutual obligations), and incidental (requesting that the judgment address a certain preliminary (incidental) issue).<sup>5</sup>

Set-off in litigation has the same objective – in most cases the defendant does not object the fact that the plaintiff's claim exists and is due, but, instead, alleges that it has been extinguished through compensation against the claim that he (the defendant) has against the plaintiff.<sup>6</sup> Things are further complicated due to the fact that civil law systems (including ours) treat set-off as a matter of substance, while the set-off defense is of procedural character.<sup>7</sup> Claims are extinguished *ex tunc*, as a result of debtor's unilateral expression of will, and there is no particular requirement of form with regard to this statement.<sup>8</sup> On the other hand, set-off defense is launched within litigation, and the claim is considered to be extinguished once the court declares it to be so, and not simply because the defendant claims that it is.<sup>9</sup> Set-off defense does not extinguish the claim. Instead, it enables the court to reach a constitutive decision with that effect<sup>10</sup> through applicable substantive law.<sup>11</sup>

---

4 Zakon o parničnom postupku (Law on Civil Procedure) Sl. Glasnik RS (Official Gazette of the Republic of Serbia) 125/04, Art. 192.

5 Poznić B., Rakić-Vodinečić V.: "Građansko procesno pravo", 15 ed., Beograd 1999., p. 352, Triva S.: "Građansko procesno pravo", 2. ed, Zagreb 1972, p. 354.

6 Alternatively, the defendant may raise the objection conditionally. While civil law compensation depends on admitting that the other side has a valid claim, procedural compensation may be conditional, i.e. it may exist as a 'reserve option' in the case where it is determined that claimant's claim against the defendant really exists. See Triva S., *ibid.*, p. 352.

7 Rechberger W., –Simotta D. A., Grundriss des Oesterreichischen Zivilprocessrechts, Wien 1994, p. 482. Berger, K. P.: "Set-off in International Economic Arbitration", 15 Arbitration International 1999, 53–84, p. 55. Although 'statutory set-off' is of procedural character in common law countries, its final effect on the main claim is similar to the effect given in the continental law. Coester-Waltjen D. *ibid.*, p. 37, Aeberli, P.: "Abatements, Set-Offs and Counterclaims in Arbitration Proceedings", taken from [www.aeberli.co.uk/articles/setoff.pdf](http://www.aeberli.co.uk/articles/setoff.pdf), p. 4.

8 Law on Obligations, arts. 336–338, with similar solutions in Germany, the Netherlands, Switzerland, Scandinavian countries, Japan and Korea. However, in Spain, Belgium and France consider compensation occurs *ipso iure*. See Berger, K.P., *ibid.*, p. 56.

9 Poznić B., Rakić-Vodinečić V, *ibid.*, p. 206, Triva S., *ibid.* p. 353.

10 Triva S., *ibid.*, p. 351.

11 Heider M.: "Confidentiality of information in arbitral proceedings: Raising claims in arbitral proceedings for the purpose of set-off", conference papers '20 Years UNCITRAL Model Law on International Commercial Arbitration', Vienna 2005., p. 4.

However, the defendant's choice between counterclaim and set-off has very important consequences with regard to the threshold of court's scrutiny. Set-off is a defensive tool, a 'shield', and is always capped by the amount of the plaintiff's claim.<sup>12</sup> Therefore, set-off is examined only if the court finds that the plaintiff's claim exists (it is enough to determine that the alleged claim exists only partially). Any set-off would be awarded only up to the amount actually owned to the plaintiff, and if there is any exceeding portion of the defendant's claim, it could be examined only on the basis of a counterclaim, or in the course of another litigation.<sup>13</sup> In any case, set-off triggers the beginning of litigation with regard to that particular issue (which, in turn, might later bring in the rules of *lis pendens*), and the award on merits has to address the set-off defense.<sup>14</sup>

There are two situations where the difference between a counterclaim and set-off can be effectively weighed. One is where the court determines that the plaintiff's claim does not exist. Once such a determination is made, the court would still have to decide on the counterclaim, but would not have to deal with the set-off defense anymore. The other situation is the case where the defendant's claim exceeds that of the plaintiff. If such a claim has been raised in the counterclaim, the court would have to address it in its entirety. However, if the defendant's claim has been invoked for set-off purpose (and the court has determined that the plaintiff's claim actually exists), the exceeding portion of the claim would not be addressed.

## 1.2. Counterclaim and set-off in international commercial arbitration

### 1.2.1. Counterclaim and arbitration

However, a counterclaim may be raised in the course of arbitration only if it falls within reach of the arbitration clause.<sup>15</sup> This follows from the basic principle that arbitral jurisdiction is based on the will of the parties, and that arbitral tribunal may decide only on the issues which fall

---

12 Berger K.P., *ibid.* p. 60, *Stooke v. Taylor* (1880) 5 QBD 569.

13 Poznić B., Rakić-Vodinelić V, *ibid.* p. 206–207, Triva S., *ibid.* 353. ICC 5971, Coester-Waltjen D.: "Die Aufrechnung im Internationalen Zivilprozessrecht" in Prutting/Ruessmann (ed.) "Festschrift fuer Gerhard Lueke, Munich 1997, 35–49, p. 37; BGH 20. 12. 1956., p. 23.

14 According to Poznić B., Rakić-Vodinelić V, *ibid.* p. 206., Triva S. *ibid.* pp. 352–353. Of course, set-off defence is examined only if the plaintiff's main claim is found to exist.

15 Poznić B.: "Protivtužba u arbitražnom sporu", 421, Poznić: "Granice arbitražnog sporazuma", 1824 et seq., Knežević G.: "Međunarodna trgovačka arbitraža", Beograd 1999., p. 49, Jakšić A.: "Međunarodna trgovinska arbitraža", Beograd 2003, p. 269.

under the scope of the arbitration clause (or a subsequent arbitration agreement).<sup>16</sup>

Theory and practice are unanimous when it comes to counterclaims arising out of the same legal relationship as the original action.<sup>17</sup> Given the fact that arbitration agreements concluded *ex post* are by far fewer than arbitration clauses, and given that most of the arbitration clauses have a fairly wide scope, the objective reach of arbitration clauses will, in most cases, cover possible counterclaim and set-off defenses arising out of the same legal relationship. The issue of connexity should not pose significant problems, given the dubious nature of the very issue of connexity and the practical problems posed by applying such a standard.<sup>18</sup>

However, the issue of counterclaim admissibility may still become a bone of contention. For instance, if arbitration clause provides for jurisdiction of a tribunal (or institution) with a seat in the country of the respondent (so there are two potential fora and the final choice depends on ‘who shoots first’), one might ask if the respondent has to raise a counterclaim in his own country, or to initiate another arbitration in the country of the claimant.<sup>19</sup> A significant number of institutional rules provide that jurisdiction over counterclaim exists whenever a counterclaim is based ‘on the same agreement to arbitrate’, or on the ‘same relationship’.<sup>20</sup>

Therefore, if institutional rules expressly refer to the arbitration agreement provisions, a ‘split’ arbitration clause would preclude lodging of a counterclaim. However, if institutional rules only state that a counterclaim is allowed, one may wonder if such a provision may be derogated by arbitration agreement. This question may be answered only

---

16 Redfern A.-Hunter M.: “Law and Practice of International Commercial Arbitration”, 4th ed., London 2004, p. 295; Born G.: International Commercial Arbitration, 2nd ed., Hague 2001, p. 298 et seq., Fouchard Gaillard Goldman on International Commercial Arbitration (ed. Gaillard E., Savage J.), The Hague 1999 (hereinafter ‘Fouchard Gaillard Goldman’), p. 1222.

17 Lew J., Mistelis L., Kroll S.: “Comparative International Commercial Arbitration”, Kluwer 2003, 153, Jakšić A. *ibid.* Similarly, UNCITRAL Arbitration Rules, Art. 19.

18 More on this Poznić B.: “Granice arbitražnog sporazuma”, 1825.

19 Poznić B.: “Protivtužba u arbitražnom sporu”, p. 423.

20 Article 23 of the Foreign Trade Court of Arbitration with the Chamber of Commerce and Industry of Serbia, Article 15 of the Permanent Court of Arbitration with the Croatian Chamber of Commerce, Article 3(2), International Arbitration Rules of the American Arbitration Association, Article 7a Rules of Arbitration and Conciliation of the Vienna Arbitration Centre, Article 19(1) Commercial Arbitration Rules of the Japan Commercial Arbitration Association. Similarly with regard to ICC arbitration Derains Y., Schwartz, E.: “A Guide to the new ICC Rules of Arbitration”, Kluwer 1998, p. 72.

after a thorough analysis of the arbitration institution rules in their entirety, and, accordingly, of *lex arbitri* provisions.<sup>21</sup>

### 1.2.2. Set-off defense before arbitration

The scope of arbitration clause represents a limiting factor when it comes to the effective use of the counterclaim. Although attack is often the best defense, should it become clear that the counterclaim, pursuant to arbitration agreement, does not lie within the competencies of the tribunal, the defendant may resort to a set-off defense. At this point, legal terminology becomes relatively uniform, which is doubtlessly the consequence of English being the *lingua franca* of international commercial arbitration.

However, an arbitration procedure, often without need to refer to national legal concepts and apply a particular set of national rules, frequently dims the distinction between counterclaim and set-off defense.<sup>22</sup> It is sometimes noted that the set-off has been carried out through a counterclaim,<sup>23</sup> and on other occasions a set-off defense is labeled as a 'counterclaim in disguise'.<sup>24</sup> Berger notes that the set-off and counterclaim are only 'a hair breadth's away' before international commercial arbitration, that they are often based on similar factual background (reciprocal debts of the parties), that the motivation and goals of their use are similar, and that they often result in similar decisions.<sup>25</sup>

Nevertheless, those similarities are deceptive. From the standpoint of the defendant, set-off is better since it does not raise the issue of the objective reach of an arbitration agreement.<sup>26</sup> Given that the declaration of set-off may have effects even without the arbitration, the tribunal's task is only to examine whether the plaintiff's claim has been extin-

---

21 Poznić B., "Protivtužba u arbitražnom sporu", pp. 423–424, and finally *in favorem compromissi* with regard to the Rules of Foreign Trade Court with the Yugoslav Chamber of Commerce which were in force at the time.

22 For detailed assessment of set-off treatment (or lack thereof) in rules and legislations worldwide, see Kee C.: "Set Off In International Arbitration – what can the Asian region learn?", *Asian International Arbitration Journal*, 1/2005, p. 141.

23 Hanotiau B., commenting on ICC case no. 5801 in "Problems Raised by Complex Arbitrations Involving Multiple Contracts – Parties – Issues" 18 *Journal of International Arbitration* (2001) 251–360, p. 286.

24 Berger K.P., *ibid.* p. 58.

25 *Ibid.*, pp. 54–58.

26 However, Article 19(3) UNCITRAL Arbitration Rules envisages that a respondent may raise a counterclaim or set-off defense only if they arise out of the same contract. In this case, unilateral expression of will would give way to procedural prohibition of set-off – see Jakšić, *ibid.*, p. 269, footnote 1113.

guished, if such issue is contentious.<sup>27</sup> The role of the law applicable to the set-off declaration is watered down, since arbitrations sometimes invoke the possibility of set-off as a general principle of international commercial law.<sup>28</sup>

On the other hand, the fact that the set-off is limited up to the amount requested by the plaintiff represents a serious limitation of its scope, rendering the reach of set-off limited. If the sole goal of the defendant is procedural economy, raising the set-off has less sense if the defendant's claim exceeds that of the plaintiff. Namely, in such situations the defendant would have to seek the remaining portion of its claim before some other tribunal or before a court. Furthermore, even though the issue of connexity is seldom a problem in relation to set-off, the situation is less than clear when a set-off claim is subject to a forum selection clause, or arbitration clause pointing to a different arbitration institution (tribunal).

Finally, as distinguished from the fate of set-off defense in similar situations, the tribunal will decide on the counterclaim even when the main claim (action) has been revoked. Therefore, a counterclaim, unlike a set-off defense, has its independent legal destiny. Legal effectiveness of a counterclaim is tied to the success of the plaintiff's main claim.<sup>29</sup>

## 2. NEW SWISS ARBITRATION RULES

Given the fact that Switzerland represents one of favorite 'arbitration destinations', Swiss legal developments are being closely watched by lawyers all over the world. When it comes to arbitral jurisdiction over set-off claims, curiosity is more than justified. For quite some time, Swiss arbitrations offer quite a unique perspective on this matter.

Starting from January 2004, six Swiss arbitral institutions (Basel, Bern, Geneva, Lausanne, Lugano and Zurich) have adopted uniform rules

---

27 Poznić B. "Granice arbitražnog sporazuma", p. 1826.

28 Fouchard, Gaillard, Goldman, p. 834, invoking, *inter alia*, ICC case no. 3540. Berger, on the other hand, distinguishes between procedural admissibility of set-off, which he considers to be governed by *lex loci arbitri*, and the law applicable to the merits of the set-off defense, arguing that this issue should be governed by the law governing the main claim. See Berger K.P., *ibid* p. 63. Bertrams has reached the same conclusion somewhat earlier, rejecting so-called cumulative approach which would check admissibility of set-off defense against requirements of laws applicable to both claims. See Bertrams R.I.V.F.: "Set-off in Private International Law" in "Comparability and Evaluation: in Honour of Dimitra Kokkini-Iatridou", edited by Boele-Woelki, Grosheide F.W., Hondius E.H., Steenhoff G.J.W., The Hague 1994., pp. 153–165.

29 Berger K.P., *ibid* p. 60.

with regard to international disputes. Previous rules remain in effect as regards internal (entirely Swiss) arbitrations. Therefore, when parties now choose one of the above mentioned six chambers to resolve their dispute, they in effect choose the Swiss Rules of International Arbitration (hereinafter Swiss Rules), to a great extent based on UNCITRAL Arbitration Rules.<sup>30</sup>

Uniformity is, however, often achieved by adopting a majority rule or principle. Such was the fate of one of the most controversial provisions to be found in the rules of the Swiss chambers. Namely, new Swiss Rules confirm that *'Le juge de l'action est le juge de l'exception'*<sup>31</sup> – the principle according to which the tribunal has to decide on all defenses raised against the main claim. This principle has been included in Article 21(5) of the Swiss Rules, which reads:

*"The arbitral tribunal shall have jurisdiction to hear a set-off defence even when the relationship out of which this defence is said to arise is not within the scope of the arbitration clause or is the object of another arbitration agreement or forum selection clause."*

Drafters of the Swiss Rules have obviously had procedural economy as their prime consideration. At first glance it appears that this has been done at the expense of the 'mother of all arbitration rules', stating that one has to respect the will of the parties, embodied in an arbitration agreement. Namely, Article 21(5) requests the tribunal to decide on set-off defenses arising out of relationships under the jurisdictional scope of another tribunal or a court. This raises several interesting questions: whether this rule requires the tribunal to establish jurisdiction, or merely allows it to do so; whether 'set-off defense' should be understood in its stricter or broader meaning and, finally, if situations where this rule is likely to create problems may already be identified.

## 2.1. Discretion and Article 21(5)

Even though a careful lawyer might instinctively want to curb the scope of such a 'brave' provision, several reasons speak for its mandatory application by the tribunal. Firstly, the very language of 21(5) suggests its imperative nature – *'shall have jurisdiction'* and not, e.g., *'may exercise'* or *'may decide on'*. Further, although the Swiss Rules are based on UNCITRAL Rules, they remain Swiss, and continental legal systems

---

<sup>30</sup> Introductory part of Swiss Rules, point b).

<sup>31</sup> BGHZ, 5. 5. 1959. Berger K.P., *ibid.* p. 72 lists arguments for this position: if the set-off defense is of substantive nature (Verrechnung, compensation legale, etc.), it represents a substantive defense (since it denies the very existence of the claim) and should, therefore, always be admissible.



generally do not allow its adjudicators to exercise jurisdiction at their own discretion. Therefore, there is room for application of the *forum non conveniens* doctrine, unless the seat of a Swiss Rules tribunal is located in a common law country. In such a case, one may imagine the *forum non conveniens* rule being incorporated into the *lex arbitri*. Thirdly, treating the 21(5) rule as discretionary may backfire – during procedures for setting award aside or its recognition, a court may find that non-application of 21(5) has resulted in a procedure not in accordance with the arbitration agreement.<sup>32</sup>

On the other hand, cautiousness calls for a slightly more reserved approach. The underlying reason is simple and very convincing – the wording of Article 21(5) explicitly expands into the scope of other arbitration clauses or forum selection clauses. Unconditional application of Article 21(5) may lead to potentially conflicting decisions of two arbitral tribunals, with adverse long-term consequences for the alleged object of protection – procedural economy.

If a set-off defense is raised before a Swiss tribunal, and the claim from which the set-off arises should exceed the claim of the plaintiff, the situation is further complicated in case the claim on which the set-off is based is covered by another arbitration agreement. One may imagine the situation whereby a Swiss tribunal determines that both claims exist. In such a case, the tribunal would declare a set-off, and the defendant would have to collect the remaining portion of his claim before the second arbitration tribunal.

The second tribunal has limited options. Given that no arbitration tribunal is bound by a decision of another tribunal,<sup>33</sup> the claimant (appearing as respondent before a Swiss arbitration) may invoke a Swiss award as *res judicata*. Since the arbitral tribunal can not decide on recognition as a preliminary matter, it would have to stay the procedure and await the end of the recognition process. Should the recognition procedure be completed successfully, the second tribunal would be bound by the holding of the Swiss tribunal (dealing with the existence and amount of the defendant's claim), effectively reducing the second tribunal to an 'extended arm' of the Swiss tribunal. Its task would be simply to rubberstamp the decision already reached. If the court should refuse to recognize the arbitral decision, the second arbitration might consider itself competent to decide on the entirety of the claim (ignoring the decision of a Swiss tribunal).

---

32 Article V (1) (d) of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

33 Redfern A. – Hunter M. *ibid.*, p. 460.

Matters get even more complicated if both tribunals are to decide on the counterclaim simultaneously. For instance, parallel to raising a set-off defense before a Swiss tribunal, the respondent commences another arbitration and requests it to determine the principal claim to be non-existent. Even if the tribunal would ‘borrow’ *lis pendens* rules of the *lex arbitri*, the outcome of invoking a *lis pendens* defense is uncertain. *Kompetenz-Kompetenz* principle enables the arbitration to assess its jurisdiction independently of the view taken on that issue by other courts (tribunals), but leaves open the possibility that such a perception may contradict the perception of other relevant bodies (courts or tribunals).

Exclusive jurisdiction of domestic judiciary represents a ground for rejecting a *lis pendens* defense. Arbitration agreements establish the exclusive competence of the prorogated tribunal. A *lis pendens* defense would, therefore, be rejected. However, this line of argument would be overtly simplified. Swiss tribunals also base their jurisdiction on an arbitration agreement. The difference lies in the fact that the jurisdiction is less clearly delineated, since Article 21(5), in a unique fashion, allows it to penetrate the jurisdiction sphere of other arbitral institutions and courts. One may wonder whether the subsequent prorogation of Swiss tribunal means that the parties have made peace with the possibility that Article 21(5) may supersede earlier arbitration clauses and forum selection clauses.

## 2.2. Back-door counterclaim?

Given that even the best of intentions do not necessarily result in improvement of procedural economy, it is worth exploring whether such an improvement may result from expanding the scope of Article 21(5) to include counterclaim as well. This may rest on the following reasoning: if there is a risk that two tribunals may arrive to conflicting decisions, the best way out is to decide on everything as early on as possible. If the respondent’s claim should exceed that of the claimant, it will be better to prevent a subsequent collection of the ‘remainder’ before another tribunal, and possible complications later on. Therefore, the reasoning goes, a counterclaim should be allowed from the very start, even if it arises out of an unrelated relationship which is subject to another arbitration agreement.

There are obvious deficiencies to this approach. Firstly, Article 21(5) would have to be interpreted *contra legem*. The Swiss Rules clearly distinguish between a counterclaim and a set-off,<sup>34</sup> and both terms are explicitly mentioned in several articles. However, Article 21(5) mentions

---

34 E.g. articles 3(9), 3(10), 19(3) of the Swiss Arbitration Rules.

set-off only. Therefore, the Rules clearly avoid blurring the distinction between these two concepts.<sup>35</sup> Secondly, this provision represents an exception from the UNCITRAL rules, on which the Swiss Rules are based. The exception is deliberate, but it should be interpreted strictly.

Finally, those observing the process of creation of the Swiss Rules suggest that the drafters have clearly intended to underline the distinction between a purely defensive set off defense and counterclaim – the latter has to be covered by arbitration agreement. Although there were ideas for Article 21(5) to include a counterclaim, the final wording is the result of the wish to strike a balance between the right of respondents to defense, on the one hand, and respect of other arbitration clauses, on the other.<sup>36</sup>

Even if one were to ignore the above mentioned reasons, this idea would fail in purely practical aspects as well. Namely, extending the scope of Article 21(5) so as to cover counterclaims as well would be effective only in cases where a tribunal determines that both claims exist, and decides on both. In all other cases procedural economy would not be improved. However, a rather unpleasant side effect would be the perception of arbitration services customers that, although several arbitration agreements were concluded between the same parties, covering different contracts, the launch of one claim before a Swiss tribunal is enough to result in unforeseen attraction of jurisdiction. Last but not least, broad interpretation of Article 21(5) might open a possibility of attacking an award on grounds that it has been decided *extra petita*.<sup>37</sup>

### 2.3. Scope of Article 21(5)

As already submitted, Article 21(5) does not represent an absolute novelty in international commercial arbitration. However, what once was a procedural peculiarity before certain Swiss commercial chambers, has now entered the grand stand of unified rules. Does this unification further enhance the credibility of the idea for set-off jurisdiction to be formulated broadly? May one envisage situations in which this article will turn out to be more or less appropriate?

---

<sup>35</sup> However, in his paper, presented at 12th Croatian Arbitration Days (December 2004, unpublished), Pierre Karrer leaves open the possibility of applying Article 21(5) to counterclaims as well (Karrer P.: “Arbitration under the Swiss Rules of Arbitration in Switzerland and Elsewhere”, p. 6.)

<sup>36</sup> Peter W., ASA 22 Special Series (2004), p. 9.

<sup>37</sup> Challenge against the award on grounds that the tribunal has decided in excess of competences granted to it by the parties (in this case, scope of competencies is also governed by Article 21(5) as part of the rules to which the parties have agreed upon). This should be distinguished from *ultra petita* decisions, where tribunal decides on issues falling outside the cause of action brought before it.

Firstly, if no prorogation of other arbitration or of a court is present, the possibility of conflict is lowered to a minimum. Two key factors increase the possibility of unwanted complications: one is the existence of forum selection or arbitration clause covering relationship out of which set-off arises. The additional complicating factor is the amount of the respondent's claim. If it is larger than the sum owed to the claimant, procedural economy argument seems pointless.

Two scenarios appear to be particularly illustrative. The first scenario covers a situation where a procedure is launched on the basis of another arbitration (forum selection clause) in order to collect the remainder of the sum owed to the respondent. The other situation sees both arbitral tribunals (or, alternatively, a tribunal and a court) deciding parallelly on the sum owed to the respondent. Therefore, the problem boils down to *res judicata* effects of arbitral awards and *lis pendens* before international commercial arbitration.

### 2.3.1. Decision on set-off as *res judicata*

The *res judicata* doctrine exists in all legal systems. Admittedly, significant differences are present with regard to how the said systems distinguish among the so-called positive and negative aspects of *res judicata* and the role played in the procedure by this concept. In continental systems, *res judicata* usually encompasses only the holding, while the common law systems extend this effect to *ratio decidendi* as well.<sup>38</sup> In addition, common law systems recognize a doctrine of 'estoppel', i.e., a procedural preclusion which may apply to a cause of action (*cause of action estoppel*) or a factual or legal issue (*issue estoppel*). Estoppel prevents invocation or challenging of rights contrary to an already existing court decision.<sup>39</sup>

However, a foreign court decision may extend its *res judicata* effect only if it is successfully recognized. The scope of *res judicata* effects will depend on the law of the country of the recognition. In our case, foreign court decisions cannot be accorded more effect than domestic ones,<sup>40</sup> which in turn means that *res judicata* effect will be given only to holdings of foreign decisions.

---

38 But not to *obiter dictum*. However, in France, Switzerland, Belgium and the Netherlands *ratio decidendi* is considered necessary in order to understand the scope of the holding. For further details, see "Res Judicata and Arbitration", Interim Report, International Law Association, 2004 Berlin Conference, p. 15.

39 This also encompasses issues determined in *ratio decidendi*, but not those touched upon in *obiter dicta*, *ibid*, p. 7. See also Hanotiau B.: "The Res Judicata Effect of Arbitral Awards", ICC Bulletin 2003, p. 43.

40 Article 86 (1) of Serbian Private International Law; Varadi T., Bordaš B., Knežević G, "Međunarodno privatno pravo", Novi Sad 2001 . p. 531.

In case of arbitration, however, one may wonder whether a foreign decision has to undergo formal recognition process in the country of the seat of arbitration in order to represent *res judicata*. In addition, is a tribunal bound by the way in which *lex arbitri* interpretes *res judicata*? As for the recognition itself, regardless of the international character of arbitration, it has to be bound by decisions having successfully undergone recognition procedure in the country of its *situs*. Should such recognition not be present, the arbitration is not obliged to take into account the decision of another court, including its factual background and legal reasoning. With regard to the reach of *res judicata*, arbitral tribunals have occasionally applied standards of the country of their seat,<sup>41</sup> or of applicable substantive law<sup>42</sup>, with regard to the scope of operation of another arbitral decision.

All this taken into account, a decision on set-off defense reached by a Swiss arbitration would bind another arbitration (which has to decide on the remainder of the sum owed) only if the Swiss award has been recognized in the country of the seat of the other tribunal. Holding of an arbitral award would normally contain a statement with regard to the existence and the amount of counterclaim. Therefore, the scope of *res judicata* will rarely present an additional problem.

### 2.3.2. Parallel deliberation on the set-off defense

Article 21(5) opens the possibility that two tribunals may parallelly deliberate on the same counterclaim raised for the purpose of set-off (before two arbitrations, or before a Swiss arbitration and a court of another state). The most interesting situation is, of course, the one in which two arbitrations decide parallelly, and one may wonder whether rules of *lis pendens* may be applied in arbitration procedure as well, or whether a tribunal's examination of its own jurisdiction is carried out without taking into account arbitrations already initiated elsewhere.

Recent practice of Swiss courts supports the view that an arbitral tribunal has to apply *lis pendens* rules of its *situs*.<sup>43</sup> The courts find en-

---

41 ICC case no. 2745/2762 (1977), in ICC Collection of Awards 1974–1985, Paris 1990, p. 326.

42 ICC case no. 3267 (1984).

43 *Fomento de Construcciones y Contratas S.A. v. Colon Container Terminal S.A.*, decision of Swiss Supreme Court of May 14, 2001, English translation in *ASA Bulletin* 2001, p. 505 et seq. The Swiss Supreme Court held that an arbitral tribunal may not simply shield behind the existence of the arbitration agreement, and that *ordre public* mandates avoidance of parallel proceedings. It is rather bizarre to observe invocation of *ordre public* argument, given the fact that the *lis pendens* objection has to be raised by the parties, rather than *ex officio*.

couragement for such a position in the fact that the *res judicata* principle, having the same goals to a certain extent, already operates in arbitration.<sup>44</sup> The most interesting aspect of this analysis will always be the determination of indirect jurisdiction, i.e. the determination whether the other tribunal (court) has jurisdiction.

The conditions for assessing indirect jurisdiction vary: on the one hand, there is a system of bilateralisation,<sup>45</sup> on the other, a liberal position, according to which indirect jurisdiction always exists, unless the matter falls within the exclusive competence of domestic judiciary.<sup>46</sup> However, even if a tribunal subscribes to this methodology, i.e., borrows the *lis pendens* rules from the *lex arbitri*, should it treat its own jurisdiction, based on the arbitration agreement, as exclusive?<sup>47</sup> If a tribunal subscribes to such view, parallel procedures are inevitable.

The very logic of exclusive jurisdictions dictates that no regard should be given to the competence of another tribunal (be it court or arbitration). If a Swiss arbitration faces a court chosen by the parties, one should not expect the court to show any flexibility. If, on the other hand, it is faced with another arbitral tribunal, the conflict of their jurisdictions has to be solved.

A possible solution would be that both tribunals treat their competence as ‘relatively exclusive’ or ‘concurrently exclusive’.<sup>48</sup> Although the expressions are to a certain extent *conradictio in adjecto*, the scope of Article 21(5) actually places both tribunals on equal footing, i.e. they are both exclusively competent from their own standpoint to decide on a counterclaim raised for the set-off purpose before a Swiss arbitration. Therefore, whoever is the first to raise a counterclaim (similarly to the ‘split’ arbitration clauses) would, in effect, determine the tribunal which would then be exclusively (without any reservations) competent to decide on that issue.

---

44 Oetiker C.: “The Principle of Lis Pendens in International Arbitration: The Swiss Decision of Fomento v. Colon”, 18 *Arbitration International* Vol. 2 (2002), p. 137–145, p. 139 et seq.; Geisinger E., Levy L.: “Lis Alibi Pendens in International Commercial Arbitration”, ICC Bulletin 2003 p.53 et seq.

45 E.g. Article 26 of the Swiss Private International Law.

46 Article 89 of Serbian Private International Law, for comparative overview see Varadi T., Bordaš B., Knežević G, *ibid.*, p. 533, listing Hungarian, Turkish and French laws in this group as well.

47 F. Perret lists such decision of an arbitral tribunal in “Parallel Actions Pending before an Arbitral Tribunal and a State Court: The Solution under Swiss Law”, ASA Special Series No 15, 2001, p. 336.

48 This expression has been used in a slightly different manner in Varadi T., Bordaš B., Knežević G, *ibid.* p. 489.

The other solution would be to fall back on the view of arbitral jurisdiction as exclusive, but at the same time engage in analysis of the timeline in which arbitration clauses have been concluded, i.e. accord preference to the arbitral institution whose jurisdiction has been contracted for at a later point in time. This solution is overtly simplistic, since a later agreement on the Swiss arbitration jurisdiction does not derogate any earlier arbitration agreement. In a way, it only creates a possibility that their competences might overlap in the future.<sup>49</sup>

### 3. CONCLUSION

A counterclaim, especially when raised for the set-off purpose before an international commercial arbitration, operates in a way which differs from the way these procedural actions are handled before the court. The key difference is that the jurisdiction of an arbitral tribunal over a counterclaim and set-off is more difficult to establish, given that it always tests the objective reach of an arbitration agreement. While the jurisdiction of a court results in an attraction of procedures which one might have had started before other competent courts, attraction conditions are harder to reach in arbitration.

Under such circumstances, the introduction of the ‘Swiss rule’, according to which a tribunal may decide on a set-off defense even if it is subject to other arbitration agreements or forum selection agreements, seems to be a very risky move. When deciding on their own jurisdiction, tribunals rely on division of competences contained in arbitration agreements. Each arbitration will take into account only its own jurisdiction. If doubts arise as to the exact scope of that jurisdiction, the scopes of other arbitration agreements or forum selection clauses may represent an important indication of the point where jurisdictions border or overlap. However, Article 21(5) of the Swiss Rules commands that such an indication shall not be taken into account, and that a tribunal has to ignore the scope of other arbitration or forum selection clauses.

The improvement of procedural economy is the goal of such a solution. However, a Swiss tribunal will not enjoy any discretion in asserting jurisdiction over a set-off defense. The rule is firm, clear and inevitable. The proclaimed efficiency aim might, however, be endangered, especially if there is an arbitration agreement or a forum selection

---

<sup>49</sup> Liebscher C.: “The Healthy Award”, *The Hague* 200, p. 431, offers a critique of solutions hiding behind the ‘implicit will of the parties’. However, and without elaborating further, Liebscher proposes to allow a set-off defense whenever it is made possible by ‘applicable substantive law’.

agreement encompassing a counterclaim as well, and if the party against whom the set-off defense has been invoked uses all available means and arguments to move the issue before the tribunal explicitly designated to decide on it.

Although Article 21(5) does not represent an absolute novelty, its promotion in the new Swiss Arbitration Rules is not the most fortunate of developments. Despite the Swiss arbitration standing and importance, one can hardly expect to witness emulations of the rule in the future national legislation or rules of arbitral institutions.