

Court Rules on Forfeiture of Right to Rely on Arbitration Agreement

Contributed by [Advokatfirman Vinge](#)

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A company filed a lawsuit at a district court claiming compensation for costs related to an arbitration that the arbitral tribunal had dismissed without prejudice. The basis of the claim was that the arbitration had been dismissed because the defendant had not provided its share of security for compensation to the arbitrators. The district court and the court of appeal dismissed the claim without further hearing, stating that the defendant had not forfeited its right to rely on the arbitration agreement as a bar to court proceedings in the substantive matter at hand. The Supreme Court subsequently granted leave to appeal. The Supreme Court ruling is pending.

Facts

Section 5(3) of the Arbitration Act provides that a party shall forfeit its right to rely on the arbitration agreement as a bar to court proceedings where the party fails to provide its share of the requested security for compensation to the arbitrators within due time.

In 1997 Systherm Info (domiciled in Poland) and Kordab International AB (domiciled in Sweden) concluded an agreement on the development, marketing and sale of software. The agreement contained an arbitration clause. Claiming that Kordab had breached the agreement, Systherm filed a request for arbitration against Kordab in 2001. After two years of arbitration proceedings, the arbitral tribunal requested additional security for the arbitrators' compensation. Systherm paid its share. However, Kordab failed to pay its share. The tribunal gave Systherm the opportunity to pay Kordab's share; otherwise, the arbitration would be dismissed without prejudice. Systherm chose not to pay. Consequently, in 2003 the tribunal dismissed the arbitration without prejudice.

Subsequently, Systherm filed a claim for damages against Kordab at a district court. Systherm claimed that Kordab's failure to pay its share of the security for the arbitrators' compensation constituted a breach of the arbitration agreement, which had resulted in damage for which Kordab was liable. The alleged damage consisted of Systherm's arbitration costs, which included the compensation paid to the arbitrators, the fees paid to counsel and Systherm's own costs. Kordab filed a motion for dismissal of Systherm's claim

without further hearing, stating that the arbitration agreement was applicable to the dispute and therefore constituted a bar to court proceedings.

Further, Kordab stated that the arbitral tribunal had ruled with binding effect that the costs related to the arbitration should be born equally by the parties. Systherm claimed, among other things, that Kordab had forfeited its right to rely on the arbitration agreement as a bar to court proceedings. Systherm also argued that its claim for compensation for costs could not have been resolved in the arbitration award without Systherm paying Kordab's share of the security.

Decisions

On November 30 2004 the district court dismissed Systherm's claim without prejudice.⁽¹⁾ The court held that the purpose of Section 5(3) of the act is to ensure that a party does not lose its right to a trial of the issue submitted to the arbitrators as a result of the other party's refusal to provide its share of the requested security for compensation to the arbitrators. According to the district court, the former party is entitled to a trial in court of the issue previously submitted to the arbitrators. In the case at hand, the district court found that the issue submitted to the court was not the same as that submitted to the arbitral tribunal. Kordab was thus entitled to rely on the arbitration agreement as a bar to court proceedings in the matter at hand. Systherm's claim was therefore dismissed without prejudice.

Following an appeal by Systherm, the Svea Court of Appeal confirmed the district court's ruling on May 4 2005.⁽²⁾ The question was whether Section 5(3) provides for forfeiture of the right to rely on the arbitration agreement as a bar to court proceedings with respect to any and every dispute covered by the arbitration agreement, or only with respect to the issue that was submitted to the arbitrators. The court of appeal pointed out that the question had never been addressed in the legal history of the act or in case law. The court stated that a party's failure to pay its share of the security for compensation to the tribunal may be explained by reasons other than obstruction. Therefore, the right of the other party to initiate court proceedings should reasonably be limited to the issue submitted to the arbitral tribunal. According to the court, in the case at hand the issue was not the same as that submitted in the arbitration. Therefore, Systherm could not initiate court proceedings. The court added that Kordab's submission that the cost issue had been resolved with binding effect in the arbitration award may be dealt with in a new arbitration.

Systherm appealed to the Supreme Court, emphasizing the fact that, should the matter be submitted to a new arbitration, Kordab would most likely fail to pay security, thereby rendering a new arbitration practically impossible. On February 6 2006 the court granted Systherm leave to appeal.⁽³⁾ The case is pending.

Comment

An earlier decision addressed an issue similar to one of those at hand in this case (for further details please see "[Court Rules on Waiver of Right to Arbitrate](#)"). In the earlier decision, the court of appeal held that a plaintiff that initiates court proceedings is considered to have forfeited its right to rely on the arbitration agreement as a bar to court proceedings regarding all claims, grounds and objections that will be considered *res judicata*, irrespective of whether they are relied on in the court case. The forfeiture thus

covered the substantive matter of the claim brought by the plaintiff in court, and seemingly nothing more. The findings of the courts in the case at hand (ie, that forfeiture due to a failure to provide security is limited to the substantive matter of the arbitration in which the defendant failed to provide security) is consistent with the findings of the previous decision.

Further, the court of appeal apparently considered that the issue of whether the claim for compensation for costs related to the arbitration was *res judicata* was covered by the arbitration agreement and was thus not for the court to decide. There is no reason to question this opinion with respect to the scope of the arbitration agreement.

As regards the issue of whether the claim for costs is *res judicata*, Systherm's submission (ie, that its claim could not be resolved in the arbitration without paying Kordab's share of the security) is difficult to understand based on the available facts. Whether Systherm requested such compensation in the arbitration (eg, when informing the arbitrators of its decision not to pay Kordab's share of the security) is unknown. The award, which is available in the case file, does not mention such claim. Could not Systherm have argued - without paying the security - that the failure to pay security should be regarded as a breach of the arbitration agreement and that it should therefore be compensated for the costs related to the arbitration? The arbitrators would have had to determine whether to dismiss such a claim without prejudice or try the claim.

According to the arbitration award, the parties were ordered to pay compensation to the arbitrators jointly and severally. The award contains no order against any of the parties to pay compensation for the other party's costs and no declaration regarding the allocation of costs between the parties. Thus, Kordab's submission (ie, that the tribunal had ruled with binding effect that the costs related to the arbitration should be born equally by the parties) seems incorrect, even though the award contains a quotation of the arbitration clause providing that the costs should be born equally by the parties. According to the arbitration award, the parties requested that the arbitrators order the other party to reimburse the costs related to the arbitration up to an amount to be specified later in the arbitration. Under Section 36 of the act, arbitrators may determine the cost issue with respect to the relationship between the parties in an award pursuant to which the arbitration is dismissed without prejudice. However, the arbitrators did not determine the cost issue in the award.

As for the alleged breach of the arbitration agreement, it should not be taken for granted that a party's failure to pay its share of the security for the arbitrators' compensation must be regarded as a breach of the arbitration agreement resulting in liability for damage suffered by the other party. It is the arbitrators - not the other party - that may request security for their compensation under Section 38 of the act. Arguably, arbitrators benefit from terminating the arbitration when the requested security is not provided by one of the parties.⁽⁴⁾ According to the act, the other party may not force the arbitrators to terminate the arbitration. Therefore, arguably, Section 5(3) of the act is not based on an underlying theory of breach of contract with respect to the relationship between the parties to the arbitration agreement.⁽⁵⁾

It remains to be seen which issues the Supreme Court will address.

For further information on this topic please contact [Paulo Fohlin](#) or [Shervin Shikhan](#) at Advokatfirman Vinge by telephone (+46 31 722 35 00) or by fax (+46 31 722 37 00) or by email (paulo.fohlin@vinge.se or shervin.shikhan@vinge.se).

Endnotes

- (1) Case T 1239-04.
- (2) Case Ö 9872-04.
- (3) Case Ö 2289 05.
- (4) See Section 38 of the act.
- (5) Confer Professor Lars Heuman's article "Tystnadsplikt och underlåtenhet att ställa säkerhet i skiljetvist", JT 2000-01, page 662.

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