Les Jeux Sont Faits: Swiss Supreme Court Upholds Investment Treaty Award against Public Policy Challenge in a Gambling Case

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The Swiss Federal Supreme Court, in a rare appeal against an award in a bilateral investment treaty arbitration, confirmed its statutory restraint in reviewing arbitral awards pursuant to article 190 of the Private International Law Act ("PILA") and rejected the host state's request to set aside the award for violating substantive public policy. (*Case 4A_157/2017*, 14 December 2017)

Facts of the Case

Following the development of a market economy in the 1980s, State X undertook different measures to regulate gambling, including low-stakes gambling with slot machines. The relevant regulation was strengthened over the years, with concurrent increases in taxation. In 2009, following a scandal involving members of X's government, the regulations were again increased. With this change, all new slot machines were prohibited, with existing slot machines being allowed to remain in operation until the expiration date of their current authorization. This change too was accompanied by an increase in the taxation of slot machines.

Since 2004, three companies organized according to the laws of the State Y (which had entered into a bilateral investment treaty ("BIT") with State X) were active in X through participations in local companies operating slot machine. While these companies continued to operate their existing slot machines, the increased regulatory and fiscal burden led them to retire most machines and abandon the market entirely in 2015.

In 2014, A, B and C (the State Y companies), after failed conciliation attempts, submitted a request for arbitration against X. They claimed damages, arguing that they were victims of a violation of the fair and equitable treatment ("FET") clause in the BIT between X and Y.

A three-member arbitral tribunal was constituted with seat in Geneva, which handed down its final award on 16 February 2017. The arbitral tribunal found that X had violated the BIT's FET clause and ordered it to pay 37M zlotys, with interest. While the Arbitral Tribunal did not find that the companies had been victims of unlawful expropriation, it held that the strong increase in taxation constituted a violation of the FET standard, which warranted the payment of damages to the Claimants.

State X appealed to the Swiss Federal Supreme Court ("FSC") for the decision to be set aside.

The Supreme Court's Decision

In line with its constant practice, the FSC based its assessment on the facts of the case as determined by the arbitral tribunal. It reiterated its position that it could not correct or complete the facts on its own initiative even if they were manifestly incorrect or had been determined in a manner that was incompatible with the law; the sole exception being the grounds for review explicitly and exhaustively enumerated in article 190 (2) PILA.

With regard to the violation of the substantive *ordre public* (public policy), the Supreme Court went on to elaborate that such a violation could only be found under a very restrictive set of circumstances. Specifically, such a violation could only be seen in a decision that failed to consider fundamental legal principles and, in doing so, became irreconcilable with the essential and generally accepted system of values, which – from the point of view predominant in Switzerland – should underlie any legal system. Such principles are, inter alia, the principle *pacta sunt servanda*, the duty to act in good faith, the prohibition of abuse of law, the prohibition of expropriation without compensation, the prohibition of discrimination and the protection of minors and vulnerable adults. Moreover, a violation of the substantial *ordre public* could only be found in a decision whose outcome (rather than just its reasoning) was incompatible with the aforementioned *ordre public*.

In the present case, the appellant argued that the decision violated the substantial *ordre public* on three different counts, namely by restricting X's fiscal sovereignty, by disregarding that it acted in the public interest of fighting the dangers of gambling, and by failing to sanction X's reasoned approach in regulating low-stakes gambling.

In rejecting the appeal, the SFC recalled that its power to review decisions under appeal depended on the arguments invoked against the appealed decision. It then went on to clarify that this differentiated approach was the same whether the appealed decision was rendered in an investment treaty arbitration against a host state or any other type of international arbitration.

It further recalled that, in reviewing jurisdictional decisions pursuant to article 190 (2) (b) PILA, it examined questions of law freely, including any preliminary questions that were determining for jurisdiction. By contrast, when called to examine a violation of the substantial *ordre public* under article 190 (2) (e) PILA, its review was strictly limited and, consequently, it could not review an erroneous interpretation of a clause in the BIT, even to the point of such interpretation being arbitrary, if it did not fulfill the conditions of article 190 (2) (e) PILA as established in its long-standing jurisprudence.

The FSC ultimately refused to examine whether the arbitral tribunal was right to find that the substantial increase in taxation of the slot machines violated the FET clause under the BIT. It justified its refusal by pointing out that the appellant failed to substantiate how the Arbitral Tribunal's findings violated the substantial *ordre public* as defined in the context of a Supreme Court review of an international arbitral award according to PILA 190 (2) (e). Instead of referring to the relevant notion of *ordre public*, the appellant had referred to a different, vastly more expansive notion, namely a textbook definition of *ordre public* as the "sum of all legal rules issued in the interest of the community". As a result, the Supreme Court could not examine how the appellant's criticism of the appealed decision constituted a violation of the substantial *ordre public*. Consequently, the appeal was rejected.