



EUROPE

Setting-off or setting aside? Polish court holds that tribunal's refusal to consider set-off violates Polish public policy

BY ALEKSANDRA ZANOWSKA - OCTOBER 21, 2020 - 8 MINS READ



The Appellate Court in Warsaw [Case No. VII AGa 804/19^[1]] considered whether a narrow arbitration clause may be a reason for rejecting a set-off argument raised by a respondent in arbitration proceedings if the basis of the set-off claim is not covered by the arbitration clause. The Court found that in case of a set-off executed outside of the proceedings, there is no reason to exclude a defense based on this circumstance from the arbitral tribunal's jurisdiction.

Background facts

The Claimant and the Respondent concluded a Framework Sale's Agreement pertaining to the sale of electric power (FSA) under which disputes arising from this agreement were to be heard in arbitration proceedings under the Arbitration Rules of Court of Arbitration at the Polish Chamber of Commerce (PCC Arbitration Rules). Based on this framework agreement three further agreements for sale of electric power were concluded. With respect to these contracts, the Claimant issued three invoices, which were not paid by the Respondent. As a result, the Claimant initiated arbitration proceedings.

Outside the arbitration proceedings, the Respondent executed a substantive law set-off with regard to claims arising under the Claimant's invoices by delivering proper set-off statements to the Claimant. The Respondent's receivables which were set off against the Claimant's claims were not based on the FSA nor on the agreement's executing the FSA. In course of the arbitration proceedings, the Respondent in principle did not dispute the Claimant's claims, but at the same time it raised a set-off defense on the basis of the executed set-offs.

In light of this defense, the tribunal considered whether it may examine a set-off defense, if the basis of the claims subject to the Respondent's set-off was not covered by the arbitration agreement concluded between the parties. The tribunal in a separate decision found that since it did not have jurisdiction over Respondent's claims, it could not examine the set-off in the arbitration proceedings.

After the tribunal's decision, the Respondent challenged the Claimant's claims in principle and brought a counterclaim. However, it was not successful in defending its case. In the end, the tribunal in its award found that the Claimant's claim was justified and issued an award in favour of the Claimant, and held that the counterclaim was untimely filed, and thus, inadmissible.

In light of this, the Respondent filed a motion for setting aside the award in the Appellate Court in Warsaw.

The factors considered

In its motion to set the award aside, the Respondent argued among others that due to the fact that the tribunal did not consider its set-off claim, the tribunal breached the procedure applicable to the dispute and Polish public policy, including the principles of constitutional protection of property rights, and the security and certainty of legal transactions.

The Claimant argued for the dismissal of the Respondent's motion.

The decision

The court set aside the entire award.

The court decided that the Respondent's objection with regard to the breach of Polish public policy were justified. The court reasoned that the fact that the tribunal refused to consider the set-off defense violated Polish public policy.

To reach this conclusion, the court firstly considered the scope of the state's public policy and found that it should encompass not only the policies stemming from the substantive law of Poland, but also the procedural policies that are applied in Poland. While the court reiterated the rule that the setting aside of an award may be justified only if the award is in breach of basic principles of a state's policy, which is a category more narrow than mandatory provisions of law, the issue of set-off in the circumstances of that particular case met these criteria. The court considered the character of the set-off defense raised in the proceedings and decided that it should have been understood not as a procedural set-off, but rather a substantive law claim that the Claimant's claims have been satisfied, and thus – they expired. What was crucial for the court in this respect was the fact that the set-off has been executed outside of the proceedings (as permitted by the substantive law), and thus, was not equal to a simple procedural set-off. This then led the court to the conclusion that such a substantive set-off could not have been omitted by the tribunal on the basis of jurisdictional objections as it specifically referred to the existence of a valid claim on the Claimant's side. As such, the scope of the arbitration clause, even if narrow, bore no relevance in this respect. Consequently, the court decided that since the tribunal incorrectly omitted the circumstances which had to be considered in order to establish whether the Claimant's claims still remained unsatisfied, the award was flawed.

In the court's view this flaw was crucial enough to be considered a breach of public policy, namely the principle of security and certainty of legal transactions. In the court's eye, due to that flaw, on the basis of the award the Respondent could have been forced to satisfy a claim it already had satisfied. Further, it could have faced the necessity to pay interests which in light of the correctly applied law and facts might not have been due. Also, the court noted that the crucial flaw done in the award could not have been cured in other proceedings, in particular anti-enforcement proceedings, as a defense on the basis of set-off would not be allowed in the specific circumstances of the case. As such, in the court's view the award had to be set aside.

The court also found that due to the fact that the tribunal omitted the set-off defense and all evidence connected to it, it also breached another basic principle of Polish law – the rule of comprehensive assessment of evidence. In the court's view, this also justified the setting aside of the award in the circumstances of the case.

At the same time, the court dismissed Respondent's further objections to the award.

The significance

In its decision, the court made two main observations that may be useful in further understanding the scope of public policy in Poland in the context of arbitral awards.

Firstly, it is a welcome point that the court emphasized that the scope of the public policy ground for setting aside of an award in Poland has to be considered narrowly. Given the different approaches taken at times by the courts in Poland with regard to this basic, yet extremely relevant, issue, such a judgment may be used as an authority supporting the narrower scope of court review of arbitral awards.

Secondly, the court's decision with regard to the scope of an arbitral award with respect to set-off defenses may be used as a guidance for future arbitral proceedings. Indeed, the balance between the scope of an arbitral tribunal's jurisdiction and the need to hear a case in a comprehensive manner is not easy to find.

However, these conclusions cannot be applied automatically to all awards issued or sought to be enforced in Poland. The key point in the court's findings was the fact that the set-off was of a substantive and not procedural nature, and thus, should be considered a factual circumstance connected to the possible satisfaction of the claim pursued in the proceedings. Therefore, the court's judgment should not be treated as a justification for expanding the jurisdiction of an arbitral tribunal beyond the arbitration agreement in cases of procedural set-offs.

Furthermore, the judgment should not be applied in a manner that would allow courts and tribunals to overlook the parties freedom of choice of the forum for their disputes. If parties conclude on purpose a narrow arbitration agreement, allowing an arbitral tribunal or court to disregard the parties agreement would be contrary to the basic principles of party autonomy in arbitration. Thus, caution should be applied when making any jurisdictional decisions which may contradict or expand the parties agreement.

Finally, the judgment cannot be treated as a ground for an assumption that a set-off must be possible in all arbitral proceedings, or otherwise the arbitral award will be contrary to the public policy of Poland. The case heard by the court was a domestic arbitration case subject to the substantive laws of Poland. The court in the judgment relied in its reasoning to some extent on the fact that the tribunal breached the substantive law applicable to the dispute. As such, this judgment should not be directly applied to cases in which the substantive law chosen by the parties is different.

[1] Judgment of the Appellate Court in Warsaw of 18 November 2019, Case File No. VII AGa 804/19; [Available here](#) (in Polish).

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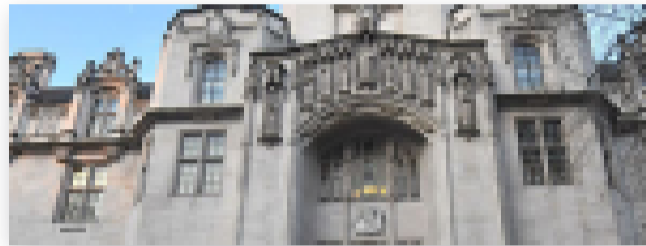
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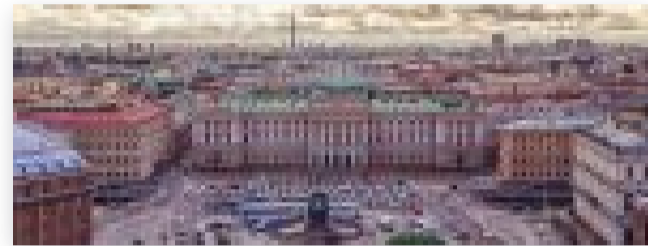
Aleksandra Żanowska is a senior associate in Baker McKenzie's Warsaw office and a member of the Firm's Global Dispute Resolution Practice Group. She specializes in arbitration, in particular investment arbitration. In addition, she represents clients in complex litigations, including IP disputes. She holds an LL.M. from Harvard Law School. In 2022, she was seconded to the arbitration team in Baker McKenzie's London office.



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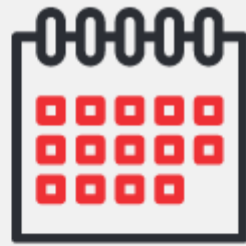
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