Kluwer Arbitration Blog

No extension of arbitration agreement to non-signatory parent company based on letter of guarantee

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Under Swiss arbitration law, the validity of an arbitration agreement is in general subject to formal and substantive requirements (Article 178 of the PILA). With regard to the formal validity, Article 178(1) of the PILA requires the arbitration agreement to be in writing and allows the parties to use any means of communication which permits the arbitration agreement to be evidenced by a text. As a general rule, the arbitration agreement binds only those parties that originally agreed to it.

In a landmark decision of 2003, the Federal Supreme Court considered that the requirement of written form did not apply to the agreement by which a non-signatory manifested its intent to be bound by the arbitration agreement. In other words, the extension of an existing arbitration agreement to a non-signatory does not need to be evidenced through a document, and, in the end, the extension is an issue of substantive validity only. As a rule, the substantive validity of an arbitration agreement with respect to non-signatories can, under Swiss law, be considered in the affirmative, if the non-signatory engaged in a behavior with respect to the conclusion or the performance of the principal agreement that either clearly demonstrates its (implied) intent to be bound by the arbitration clause, or that under the general principle of good faith may and must have been understood by the other party in such a way that the non-signatory intended to join the principal agreement, including the arbitration clause being part thereof.

In addition thereto, there are other legal grounds which may justify an extension of the arbitration agreement, in particular, (1) a subsequent ratification, succession, assignment, or other forms of transfer, (2) a valid representation, or (3) situations where the intent to evade arbitration constitutes an abuse of rights that allows a piercing of the corporate veil. In these situations, the third party would be bound by the arbitration agreement on different legal grounds than the initial parties.

In a decision of 19 August 2008 (4A_128/2008), the Swiss Federal Supreme Court specified the above-summarized legal practice as to the extension of arbitration agreements to non-signatories. The underlying case was that a Qatari contractor and a Cypriot subcontractor entered into a subcontract agreement whereby the Cypriot subcontractor undertook to perform dredging work in connection with the construction of a cooling system using sea water. The Qatari contractor undertook to pay USD 13’750’000 in exchange for the dredging work to be performed, and the Italian parent company of the Qatari contractor issued a “Parent Company Guarantee Letter” which provided, inter alia, that the guarantor will on simple demand from the Cypriot subcontractor take whatever measures may be necessary to secure the payment of obligations of the Qatari contractor under the subcontract agreement, and will indemnify and keep indemnified the Cypriot

subcontractor as if the guarantor was the original obligor.

After commencement of the construction works, a dispute arose between the subcontractor and the contractor, and the Cypriot subcontractor initiated arbitral proceedings before an ICC arbitral tribunal against the Qatari contractor and its Italian parent company (i.e., the guarantor). It requested that the respondents be ordered to pay the additional costs that had been generated by the very difficult and unexpected subsoil conditions. The Italian parent company argued that the arbitral tribunal lacked jurisdiction to hear the claim raised against it since it was not bound by the arbitration clause contained in the subcontract. After the ICC Court found that there was a prima facie valid arbitration agreement and allowed the arbitration to proceed, the arbitral tribunal rendered a preliminary award on jurisdiction and decided that the mere fact that the parent company had issued a guarantee did not make it a party to the arbitration clause of the subcontract, and it denied its jurisdiction over the Italian parent company. The preliminary award was challenged by the Cypriot subcontractor before the Federal Supreme Court, which finally upheld the decision reached by the arbitral tribunal.

The Supreme Court found that the mere fact of a party issuing a guarantee did not bind it to the arbitration clause contained in the principal contract between the creditor and the obligor. The result would have been different had the legal relationship between the subcontractor and the Italian parent company been qualified as an assumption of debt (as opposed to a guarantee) because an assumption of debt entails the transfer of all accessory rights to the new obligor, including the agreement to arbitrate in the principal contract. However, the undertaking of a non-signatory party to guarantee the performance of a party to the principal contract does not have the same effect. In order for the arbitration agreement in the principal contract to be applicable to the guarantor, the guarantee agreement must contain either a specific arbitration clause to that effect, or a provision referring to the arbitration agreement in the principal contract. Failing such a provision in the letter of guarantee, the above-mentioned general principles as to the substantive validity of an arbitration agreement with respect to non-signatories apply. This means that the guarantor must have expressed, either explicitly or by its conduct, the intention to be bound by the arbitration agreement in the main contract. The fact that the guarantor and the obligor are affiliated to the same group of companies does no alter that conclusion. Applying these requirements to the particular “Parent Company Guarantee Letter” at hand, the Federal Supreme Court ruled that the Italian parent company was not bound by the arbitration agreement contained in the principal contract.

The decision of the Federal Supreme Court confirms the restrictive conditions in which under Swiss arbitration law an agreement to arbitrate can be extended to a non-signatory third party, and it clearly declines the far-reaching approach of the French group of company doctrine. Under Swiss arbitration law it remains an uphill battle to initiate arbitration against (affiliated or non-affiliated) non-signatories unless there is clear evidence that the non-signatory intended to be bound by the arbitration agreement. Moreover, the Supreme Court’s decision draws a clear line between the legal consequences of a mere guarantee undertaking and the assumption of a debt. Only the latter entails the transfer of the accessory rights of the principal contract to the new obligor, including the transfer of the arbitration agreement.

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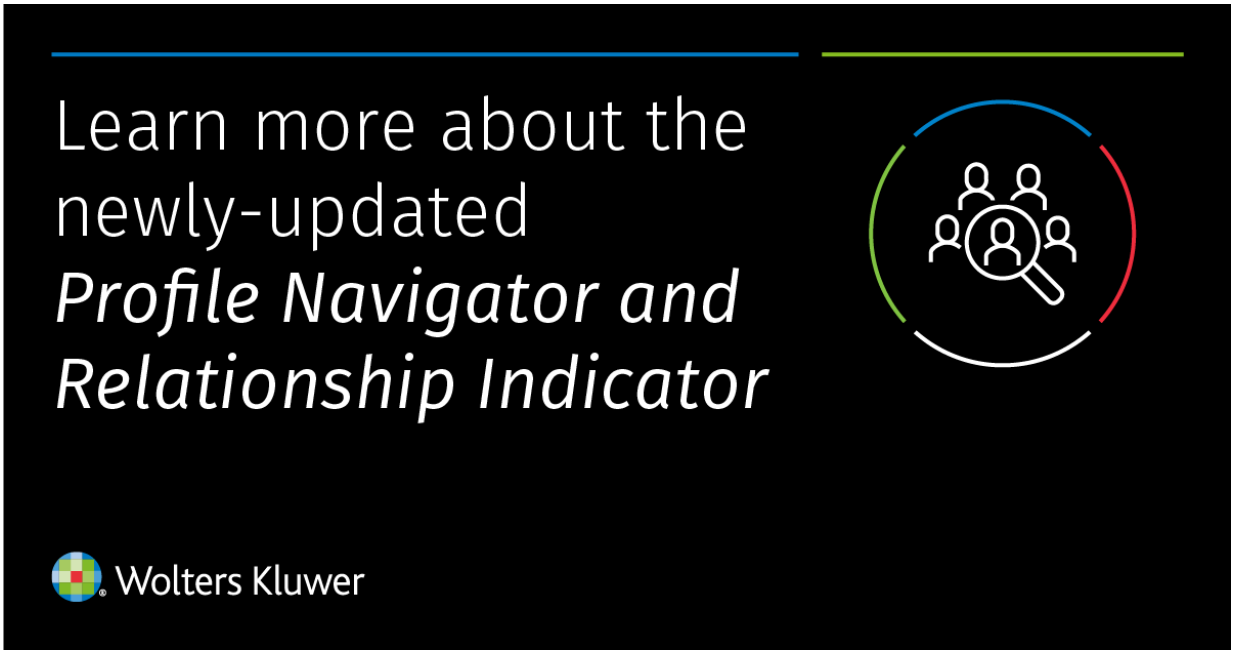

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