

Piercing the Corporate Veil - Effect on the Arbitration Clause and Jurisdiction

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In a decision of 25 August 2009 (4A_160/2009), the Swiss Federal Supreme Court held that where a claimant by piercing the corporate veil can assert a contractual claim against the majority shareholder, all rights and obligations from the respective agreement, including the arbitration clause, become binding on the majority shareholder, thus precluding the jurisdiction of the state courts.

On 7 April 2003, the complainant ("A"), a Swedish national domiciled in Italy, and the Corporation Y ("Y"), incorporated under the laws of and having its corporate seat in British Virgin Islands ("BVI"), entered into a sales agreement ("Sales Agreement") according to which A sold to Y the corporation X ("X"). The respondent ("B"), a Swedish national domiciled in Switzerland, was a majority shareholder in Y, and acted for and on behalf of Y. The Sales Agreement contained an arbitration clause to which Swedish law applied.

On 27 March 2007, A initiated an arbitration against Y in Sweden claiming payment of the remaining purchase price under the Sales Agreement in the amount of 13 million Swedish krona ("SEK") plus interest. The arbitration did, however, not proceed because sometime between 2003 and 2007 B liquidated Y.

Subsequently, A filed a claim against B at B's domicile, i.e. before the state court of the Canton of Nidwalden (Switzerland), requesting that B be ordered to pay to A

the remaining purchase price. B, in turn, argued that A should have submitted its claim to arbitration (pursuant to the arbitration clause in the Sales Agreement), whereupon the court of first instance of the Canton of Nidwalden decided that it did not have jurisdiction in this matter. A appealed against this decision before the cantonal court of second instance, which dismissed A's appeal.

In his claim before the state courts of the Canton of Nidwalden, A requested that the corporate veil of Y be pierced and that B be held responsible for the payment of the 13 million SEK. At the same time, A argued that the arbitration clause did not apply to B, because he was not a party to the Sales Agreement and because B did not succeed to the rights and liabilities under the Sales Agreement from Y. A further argued that B acted in bad faith because he liquidated Y in order to escape responsibility under the Sales Agreement, and neither B nor Y had accepted A's request for arbitration. For that reason, the arbitration clause ceased to exist under Swedish law and B should have been held responsible before the state courts. A finally argued that B was not in a position to raise the plea of arbitration because he had filed a claim for declaratory relief against A in Sweden requesting that the state court in Sweden declare that B was not liable under the Sales Agreement.

In their reasoning, both court instances held that, because of the piercing of Y's corporate veil, the Sales Agreement, including the arbitration clause, had become binding upon B. They further held that B did not act in bad faith when he filed a claim for declaratory relief against A in Sweden because one could not expect that B would voluntarily acknowledge that due to his behavior Y's corporate veil had been pierced. The courts of the Canton of Nidwalden finally held that the arbitration clause did not cease to exist because A's request for arbitration in Sweden was directed against Y and not B.

Thereupon, A appealed before the Swiss Federal Supreme Court ("Federal Supreme Court") and requested that the decisions of the courts of both first and second instance (under the so-called Dorénaz-practice) be set aside.

On the issue of piercing of the corporate veil and the applicability of the arbitration clause to B, the Federal Supreme Court referred to its established practice according to which a corporate veil of a corporation can be pierced where (i) a corporation and its majority shareholder (either another corporate entity or a physical person) are operating as a single economic entity although they are not formally identical (due to the corporate veil), and (ii) it would be inequitable, i.e. against good faith, to uphold the legal distinction between them. The Federal Supreme Court held that where a claimant by piercing the corporate veil can assert a contractual claim against the majority shareholder, all rights and

obligations from the respective agreement, including the arbitration clause, become binding on the majority shareholder. Therefore, the Federal Supreme Court concluded, the arbitration clause was binding also upon B.

The Federal Supreme Court held that the lower courts erred in reasoning that the arbitration clause did not cease to exist because A's request for arbitration in Sweden had only been directed against Y, but not against B. B's behavior, in particular his obstruction to the arbitration in Sweden, justified the piercing of Y's corporate veil and was therefore to be treated as a fact with double relevance which was, for the time being, to be deemed proven. For that reason, both Y (if it were still existing) and B were bound by the arbitration clause. Hence, it was irrelevant against whom (Y or B) A's request for arbitration in Sweden had been directed and B should have accepted A's request for arbitration.

The Federal Supreme Court concluded that the decisions of the courts of the Canton of Nidwalden were incorrect, and remitted the decision back to the court of first instance for further consideration. In so doing, the Federal Supreme Court applied Article 7 of the Swiss Private International Law Act ("PILA") which provides that the Swiss courts, in view of an arbitration agreement, should decline jurisdiction, unless the arbitral tribunal cannot be appointed for reasons that are obviously attributable to the defendant in the arbitration.

In the case at hand, the two lower courts in Switzerland confirmed B's arguments and ended their analysis there, thus rejecting A's claim. For A it seemed that, at this stage, he was not going to be able to recover the second installment without having to file for arbitration proceedings against B, i.e. the "real" buyer. The Federal Supreme Court, the third and final judicial instance, changed this rather unfortunate outcome and sent back the decision to the lower instance for further considerations. According to the Federal Supreme Court, the lower court should have to a greater extent exercised its discretion when applying Article 7 PILA. Also, it should have to a greater extent considered A's arguments pertaining to B's obstruction to the arbitration in Sweden with one of the possible consequences that, due to B's obstruction, arbitration would no longer be a viable alternative and the state courts would have to take on the case.

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