

Kluwer Arbitration Blog

Having Your Cake And Eating It Too? – Israeli Court Stays Proceedings Against A Non-signatory To A Contract Containing An Arbitration Clause

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In the recent decision of the Tel-Aviv District Court in *S. Elia Holdings Ltd. and Arie Shasha v. Ron Itzhaky*, the plaintiffs were effectively estopped from bringing claims against a non-signatory under a contract containing an arbitration clause.

The plaintiffs in the case are a private Israeli company engaged in real-estate entrepreneurship (“Elia Holdings”) and its owner, an Israeli citizen and resident. The respondent, also an Israeli citizen and resident, is the owner and controlling shareholder of the parent company of Atlas Estates, a private company incorporated in Hungary. In 2006, Atlas Estates and Elia Holdings incorporated a joint private company in Hungary (“Joint Company”) for the purpose of constructing a real estate project in central Budapest. The contracts establishing the Joint Company included an arbitration clause referring all disputes to arbitration in Hungary by the Hungarian Chamber of Commerce and Industry under Hungarian law.

In 2013, the plaintiffs brought an action against the respondent before the District Court for NIS10 million in damages allegedly caused by Atlas Estate’s mismanagement of the real estate project. The plaintiffs claimed that while Atlas Estates undertook to manage and develop the project, it had done nothing but exploit the funds the plaintiffs had invested in the Joint Company. According to the plaintiffs, this resulted in a significant tax liability for the Joint Company in Hungary and ultimately in the seizure of the land by the Hungarian bank that had financed its purchase.

The respondent applied to dismiss the plaintiffs’ action on the ground of, *inter alia*, lack of privity. According to the respondent, he was merely a shareholder in the parent company of Atlas Estates, and was not party to any of the contracts entered into between the latter and Elia Holdings. The respondent therefore submitted that the personal action against him constituted an impermissible attempt by the plaintiffs to lift the corporate veil and circumvent the arbitration clause contained in the contracts with Atlas Estates. In response, the plaintiffs argued, *inter alia*, that their action was appropriate since the respondent was the sole and true decision maker in Atlas Estates; that the arbitration clause applied only to the signatory parties and not to the respondent; and that, in any event, they had also raised personal claims against the respondent that were not covered by the arbitration clause, such as tortious claims and claims for unjust enrichment.

The District Court noted that although the plaintiffs’ allegations were all directed against Atlas Estates, they chose to sue the respondent rather than Atlas Estate. This, the Court presumed, was in

order to escape the arbitration agreement contained in the plaintiffs' contract with Atlas Estates. The Court found, however, that the plaintiffs could not have it both ways; on the one hand demand that the respondent bear the responsibility for Atlas Estates' alleged breach of its obligations under the contracts, and on the other hand ignore the arbitration clause contained in those same contracts. Since the plaintiffs sought to enforce these contracts against the respondent in light of his alleged position in Atlas Estates, the Court found that all of the provisions contained in the contracts must apply to the respondent, including the arbitration clause. Finally, the Court dismissed the plaintiffs' argument that their personal claims against the respondent were not subject to the arbitration agreement, finding that such claims were also based on their contracts with Atlas Estates, and were therefore subject to the arbitration agreement.

Once the District Court found that the arbitration agreement applied to the plaintiffs' claims against the respondent, it further noted that arbitration agreements subject to the New York Convention, to which Israel is a party, are to be respected and lead to a stay of court proceedings in accordance with Article 6 of the *Israeli Arbitration Act*, 1968, unless the exceptions set out in the Convention apply or in exceptional circumstances. Since the plaintiffs did not argue and did not prove any of these exceptions, and since this was not an exceptional case, the Court found that the arbitration agreement must be respected and a stay of proceedings in favor of arbitration must be ordered.

In finding that the proceedings should be stayed in favor of arbitration, the District Court effectively, while not explicitly, applied equitable estoppel to prevent the plaintiffs from evading the arbitration agreement contained in the contracts, even though the respondent was not a signatory to them.

It is worth noting that in its decision to extend the arbitration agreement to the plaintiffs' claims against the non-signatory respondent, the District Court did not apply such doctrines as 'alter ego' or 'group of companies' in order to pierce the corporate veil. This would have no doubt prolonged the proceedings and require the production of extensive evidence which, as the Court itself recognized, it was not the proper forum to consider. Moreover, in previous cases (e.g., *Sohnut Mehoniyot Layam Hatihon Ltd. v. KIA Motors Corporations*) the Supreme Court of Israel has noted that, unlike in the United States, Israeli jurisprudence has yet to develop such judicial tools in order to extend arbitration agreements to non-signatories.

While in both *Sohnut Mehoniyot* and other cases (e.g., *Savrilon Ltd. vs. Citrix Systems Inc.*) the Supreme Court has extended arbitration agreements to non-signatories on the basis of its interpretation of the parties' "true intentions" or a finding of "common interests" among them, no clear rules have been developed in this regard as of yet. Although the application of equitable estoppel in such cases appears to be controversial in the United States, its use by the District Court in the present case arguably constitutes a positive step toward developing such rules in Israeli jurisprudence. Since the plaintiffs have appealed the District Court's decision to the Israeli Supreme Court, we will soon learn whether or not the Supreme Court is willing to take up this challenge.

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