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Swiss Supreme Court Extends Arbitration Agreement to a Third Party: Potential Risk for Corporate Groups

Georg von Segesser (von Segesser Law Offices) · Wednesday, June 3rd, 2015

and Katherine Bell, Schellenberg Wittmer

In 2014, the Swiss Supreme Court rendered 32 decisions on petitions to set aside international arbitral awards. Consistent with a traditionally low success rate, the Supreme Court granted only 4 of the 32 petitions. One of these four petitions was considered in a French-language decision dated 7 April 2014 (*Decision 4A_450/2013*): The Swiss Supreme Court partially upheld an application to set aside an award issued by an ICC International Court of Arbitration tribunal on the grounds that it incorrectly declined jurisdiction over one of the parties.

The case involved a dispute over the construction of industrial facilities between an aluminium company (A) and a group of companies (B). The three contracts containing the arbitration clauses were signed only between A and B1, the company within B group responsible for the construction project. The project was subsequently suspended and lengthy negotiations ensued between A, B1 and other entities of B. During these negotiations, the involved parties agreed that a specific division of B1's parent company (B2) would carry out the construction project instead of B1 and that an individual within B2 would become responsible for the management of the project. They further agreed that B2 would provide an irrevocable guarantee to A for the obligations under one of the contracts. The division responsible for the project within B2 was subsequently transferred to B3.

Party B1 initiated arbitral proceedings against A. Party A then brought counterclaims not only against B1, but also against B3. The arbitral tribunal ruled that it did not have jurisdiction over B3, since B3 had not become a party to the contracts between A and B1, but had merely become involved as a representative of B1.

The Supreme Court recalled that pursuant to the principle of the relativity of contractual obligations, the arbitration agreement included in a contract binds only the contracting parties. However, there are exceptions under Swiss law in which a non-signatory party can be considered bound by the arbitration agreement:

• Due to a formal act such as debt assignment, assumption of a debt or the transfer of a contractual relationship.
• A third party involves itself in the performance of the contract and its actions demonstrate a willingness to be bound by the arbitration agreement.

• There is confusion with regard to the respective spheres of activity of a subsidiary and its parent (one of which is a signatory).

This last extension of an arbitration agreement can derive from two different concepts. The first is the so called “Durchgriff”, which is similar to the common law notion of piercing the corporate veil. The second is the appearance to be bound pursuant to the principle of reliance. This type of liability intends to protect a party’s erroneous, but reasonable, belief that it entered into a contract with the parent rather than the subsidiary, or with both.

The Supreme Court proceeded to carefully examine the evidence and analyze whether any of the above situations were relevant in the present case and justified the extension of the arbitration agreement to B3. Based on the interpretation of a letter referring to the complete transfer of responsibility for the project from B1 to B2 (which reflected A’s express intent that B1 be replaced by another company), and in view of the unlikelihood of a parent company acting as a representative of its subsidiary, the Supreme Court rejected the arbitral tribunal’s finding that B2 was simply a representative of B1. Considering B’s complicated organizational structure, the Supreme Court further acknowledged that A should not be faulted for its inability to identify its actual partner in the project.

Finally, the Supreme Court relied on the principle of good faith enshrined in Article 2 of the Swiss Civil Code. In its view, B1 and B2 behaved in such a way that A could have believed, in good faith, that it had a legal relationship with B2, which continuously had taken decisive steps in the project. As a result, B2 should be considered bound by the contracts and the arbitration agreements. The arbitral tribunal had therefore improperly declined its jurisdiction.

However, the Supreme Court did not confirm the arbitral tribunal’s jurisdiction over B3. In finding that B2 was not a party to the contracts, the arbitral tribunal had not proceeded to examine whether B3, which subsequently acquired the responsible division from B2, would also be bound by the contracts. Consequently, the Supreme Court remanded the case back to the arbitral tribunal for a decision on B3.

This case serves as a reminder that where one entity signs a contract, but another entity assumes legal or factual responsibility for executing the contract and/or in situations in which the respective roles may not be fully apparent to the counterparty, there is a risk that the arbitration agreement will bind not only the signatory party but also non-signatory parties. If a corporate group wishes to avoid having non-signatory affiliates pulled into arbitration, it should clearly communicate which entity is or is not considered bound by the contract. In the present case, and as emphasized by the Supreme Court, in order to not become a party to the arbitral proceedings, B2 should have clearly expressed to A that it did not wish to be considered as a party to the contracts.

Albeit this being an important decision, the Supreme Court merely confirms the current legal situation. The decision does not lead to any changes in Swiss law. In particular it cannot be interpreted as a step towards the “group of companies” concept.

In principle, the Supreme Court does not review the substantive findings of an arbitral award by analyzing if the arbitral tribunal was correct on the merits. Yet when determining an issue of jurisdiction, the Supreme Court examines not only the legal grounds for jurisdiction or the lack of it but also tends to undertake a diligent review of the factual issues and legal reasons in the arbitral award. In the present case, the Supreme Court’s thorough review legitimately derives from its full

scrutiny powers in regard to legal issues in jurisdictional challenges, as well as the Swiss legal system's consideration of good faith as a legal and not a factual issue.

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