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Arbitration Clauses: Interpretation and Extension to Non-Signatories

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In a decision dated 5 December 2008 (4A_376/2008), the Swiss Federal Court ("SFC") had the opportunity to address two legal topics in the context of international arbitration:

The first topic was the interpretation of a pathological arbitration clause. B___ Ltd. ("Claimant-Company") had initiated arbitration proceedings in Lugano under the ICC rules against A.___ ("Respondent") on basis of an "Employment Contract for the post of Managing Director" of the Claimant-Company. Pursuant to the contractual document, Claimant-Company and Respondent were the sole parties to this "Employment Contract" that contained the following arbitration clause: "In case of any disputes deriving from the Contract, the parties agree that it should be the competence of the Arbitration Court of the International Chamber of Commerce of Zürich in Lugano. The language of arbitration will be Italian. The law applied will be Swiss law." Respondent disputed that any arbitral tribunal under the ICC rules could have jurisdiction based on this arbitration clause. The sole arbitrator with the tribunal's seat in Lugano dismissed Respondent's jurisdictional objection. Against this decision, Respondent appealed to the SFC.

Analysing the drafting history and the wording of the arbitration clause, the SFC came to the conclusion that the arbitration clause was to be understood as referring to ICC Court in Paris (and the ICC rules) rather than to the Chamber of Commerce of Zurich and its institutional rules (the Swiss rules). Accordingly, the SFC dismissed Respondent's appeal.

The second topic addressed by the SFC had to do with the extension of the arbitration clause to non-signatories. For the case that his jurisdictional objection would be dismissed, Respondent had filed a motion to extend the arbitration proceedings to D.___, C.___ Ltd. and B.___ ("Third Parties"). Respondent argued that even though they were not signatory parties to the Employment Contract (containing the said arbitration clause), they had been involved in the conclusion of this contract. Furthermore, Respondent argued that they were also involved in another agreement entitled "Sales Contract". The Sales Contract had been concluded on the same date as the Employment Contract. In the contractual document, Respondent, B.___ and C.____ were named as contracting parties. The Sales Contract contained an arbitration clause of the same wording as the one in the Employment Contract. According to Respondent, both the Employment Contract as well as the Sales Contract were expressions of one and the same intent, namely the purchase of 100% of the shares of Claimant-Company, as stipulated in the Sales Contract. These shares were held by C.___ Ltd. in its capacity as a Trustee for D.___, and were to be transferred to Respondent. In return, Respondent was obliged to pay the debts that Claimant-Company had vis-à-vis its previous

director B.___ and D___. Respondent argued that the purpose of the Employment Contract was in fact to safeguard this transaction. Respondent set forth the following arguments:

• Respondent argued that although only Claimant and Respondent were stated as contracting parties in the Employment Contract, D.___ was named as representative of Claimant. D.___, on its part, was represented by C.___ Ltd.
• To support its argument that the Employment Contract was a means to safeguard the full performance of the Sales Contract, Respondent pointed out various contractual provisions. The Employment Contract contained a non-competition-clause, forbidding Respondent to enter business deals in his own interest within Claimant-Company's line of business. In case of violation of this non-competition-clause (and likewise in case Respondent did not adhere to the payment of Claimant-Company's debts as stipulated in the Sales Contract) the Employment Contract entitled D.___ to appoint a "Board of Directors" that would assume the management of Claimant-Company alongside Respondent. Also, the Employment Contract entitled D.___ to immediately terminate the Employment Contract in case Respondent was found to have managed Claimant-Company in a grossly negligent manner.
• Respondent also stressed that there were several provisions contained in the Sales Contract that were complementary to the Employment Contract. In particular, the Sales Contract stipulated that upon signing of the Sales Contract, C.___ (as the owner/seller of the shares) would cause Claimant-Company to appoint Respondent (the buyer of the shares) as "Managing Director" (of Claimant-Company) and to remove B.___ from this position. Also, the Sales Contract entitled D.___ to obtain accounting information of Claimant-Company.

The sole arbitrator dismissed Respondent's motion. His appeal, however, was successful. By referring to earlier decisions, the SFC stated that even though Article 178 of the Swiss Private International Law Act required an arbitration clause to be concluded in writing, a third party may be considered as being bound by a (validly concluded) clause despite not having signed the original agreement containing the clause. The SFC mentioned that this may be the case in situations of assumption of indebtedness, assignment of debts or transferral of a contractual relation. As a further example, the SFC referred to situations in which a third party is involved in the performance of a contract containing an arbitration clause, provided that its behaviour can be construed under the circumstances as deemed to be an expression of such an intent based on the doctrine of good faith.
The SFC then analysed the specific situation. Its respective considerations may be summarized as follows:

• First of all, the SFC examined the formal parties to the two contracts and their representatives in the conclusion of the contracts (mentioned above). Based on this, the SFC came to the preliminary conclusion that the "third parties" were in any event not completely "alien" to the Employment Contract.
• As a further consideration, the SFC acknowledged that there was an overlap of the duties stipulated in the two contracts, and that this overlap led to the impossibility to distinguish these duties. According to the SFC, the two contracts as a whole were indeed geared towards a "general duty" by Respondent to pay the debts of Claimant-Company as a condition to fully take control of Claimant-Company. The Employment Contract was functional to this goal because it allowed the seller of shares (i.e. C.___ Ltd.) and the creditors of Claimant-Company (B.___ and D.___) to retain control over the Claimant-Company's activities and the revenues deriving from these activities until Respondent had paid the debts as stipulated in the Sales Contract.
• The SFC further held that in the pending dispute, the violation of the duties stipulated in the

Employment Contract has inevitably implications on the Sales Contract, and vice versa. By referring to considerations in the sole arbitrator's decision, the SFC stated that Claimant was reproaching Respondent-Company having violated the non-competition-clause contained in the Employment Contract, as well as having illegitimately assumed the position of the sole "Managing Director" of Claimant-Company, whereas Respondent reproached Claimant-Company to have failed to appoint him as "Managing Director" despite Claimant-Company being contractually obliged to this effect.

• As regards D.____ specifically, the SFC referred to D.___'s entitlement stipulated in the Employment Contract to immediately terminate this contract (holding that this was typically a prerogative of the employer) as well as to D.___'s contractual right to obtain accounting information of Claimant-Company. The SFC concluded that under these circumstances it was justified to treat D.____ as an employer (i.e. as a party to the Employment Contract).

• The SFC stated the similar considerations applied to the situation of B.____. The SFC referred to a provision in the Employment Contract entitling B.___ to re-assume his former position of "Managing Director" of Claimant-Company alongside Respondent in case Respondent would not adhere to the payment of debts as stipulated in the Sales Contract.

• As to C.____ Ltd., the SFC referred to C.____ Ltd.'s duty stipulated in the Sales Contract (as current owner/seller of the shares of Claimant-Company) to cause Claimant-Company (in the context of the Employment Contract) to appoint Respondent as its Managing Director and to dismiss B.____ from this position.

The SFC held that considering the intensive involvement of each of the third parties in the conclusion of the Employment Contract and considering the role each of them had reserved to itself with regard to the performance of the Employment Contract, each of them, by its "conduct", had to be deemed bound to the arbitration clause contained in the Employment Contract, that was (as the SFC again mentioned) identical to the one contained in the Sales Contract. Accordingly, the SFC upheld Respondent's appeal in this respect and directly ordered the arbitration proceedings to be extended to the third parties.

Hence, with regard to the issue whether an arbitration clause should also be extended to third parties who have not signed the arbitration clause, the SFC maintains its position which allows an extension only in specific circumstances. There may be other jurisdictions which have a more liberal approach, such as e.g. France under the Group of Company Doctrine. The practice of the ICC Court, on the other hand, seems to allow an extension only under the preconditions that the third party has signed the arbitration clause and the respondent has raised claims against that third party.

We invite readers to comment on these issues and to refer to cases which have dealt with the problems of extension.

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