Kluwer Arbitration Blog

Darie v. Alstom: Weakening or Reinforcing the Pro-arbitration Stance of the Israeli Supreme Court?

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Facts

The applicant, Darie Engineering (Darie), and the first respondent, Alstom Transport SA (Alstom), had a business relationship spanning over 20 years in which Darie acted as Alstom's representative in the transportation sector in Israel. Darie filed an action against Alstom and the second respondent, Alstom Israel Ltd. (the Respondents), in the Israeli District Court, alleging that Alstom was unjustly enriched at Darie's expense and claiming compensation for commissions allegedly owed to it by the Respondents for certain projects. Darie submitted with its statement of claim nine contracts, all of which contained an arbitration clause providing for ICC arbitration in Switzerland or France. The Respondents requested a stay of proceedings on the basis of the arbitration clauses contained in these contracts, which, according to the Respondents, reflected the parties' intention to submit all of their disputes to arbitration. Darie, on the other hand, argued that its action was not based on these contracts, which were provided merely as background, and that, in any event, some of them had already expired and some of the projects for which it was claiming a commission were not governed by agreements containing arbitration clauses.

The District Court decision

The Court found that Darie's claims were largely based on the contracts containing the arbitration clauses, which were broadly worded to include "all disputes arising out of or in connection with this agreement (including its validity, meaning, effect or termination)". The Court further found that these arbitration clauses should be read into the parties' entire contractual relationship and applied to all of Darie's claims, including those concerning projects with respect to which the parties did not enter into written contracts. The Court noted in this regard Article 26 of the Israeli Law of Contracts, which provides that issues that were not agreed upon in a contract may be determined in accordance with the practice of the parties. It accordingly stayed the proceedings against the Respondents.

The Supreme Court decision

The Court first dismissed Darie's appeal with regard to those claims that concerned projects with respect to which the parties had entered into written contracts containing arbitration clauses. In this regard, the Court upheld the decision of the District Court that as a result of Article 6 of the Israeli Arbitration Act and Article 2(3) of the New York Convention, the Court has limited discretion to refuse a stay of proceedings in such circumstances and that a stay was justified in this case with respect to these claims.

The Court then turned to the two specific projects with respect to which Darie argued there was no arbitration agreement in place (the Projects). The main question considered by the Court in this regard was whether arbitration clauses included by the parties in previous contracts were sufficient for the purpose of new disputes concerning transactions that were not included in those written contracts.

The Court noted that a fundamental rule of arbitration law was that a dispute may be submitted to arbitration only when there is an arbitration agreement. Furthermore, in accordance with Article 1 of the Israeli Arbitration Act and Article 2 of the New York Convention, such an arbitration agreement must be "in writing", and, therefore, in order for a court to stay proceedings in favour of arbitration, the parties must have an arbitration agreement in writing.

In the present case, the Court noted that no agreement in writing containing an arbitration clause was concluded by the parties with respect to the Projects. According to the Court, the District Court erred in relying on Article 26 of the Israeli Law of Contracts in order to read an arbitration clause into the parties' alleged agreements on the basis of their previous practice and in the absence of a written document. The Court recognized that this Article was frequently used by the courts as an interpretive tool, but found that when dealing with arbitration it must be applied narrowly and in accordance with the purposes of arbitration law and the requirement of written substantive consent.

In this regard, the Court distinguished between a situation in which the parties have an agreement in writing that contains an arbitration clause and deals with their general relationship, and which they intend to extend or renew at a later time, and a situation in which the parties have an agreement in writing that contains an arbitration clause and deals with a specific transaction. In the first situation, it may be possible to apply the arbitration clause to all of the disputes arising between the parties during their relationship, and perhaps even to those that may arise with its termination. In the second situation, however, an arbitration clause agreed upon with respect to a previous transaction cannot be read into a subsequent agreement concerning another transaction. Therefore, the Court concluded that in the present case the arbitration clauses contained in previous agreements between the parties concerning specific projects could not be read into the alleged unwritten agreements between them concerning the Projects on the basis of Article 26 of the Israeli Law of Contracts.

The Court also distinguished the present case from its previous decision in the case of *Sohnut Mehoniyot Layam Hatihon Ltd. (Car Agency for the Mediterranean Sea Ltd.) v. KIA Motors Corporations*, which the District Court cited in support of its finding that the arbitration clauses contained in the parties' previous contracts should be read into all of their agreements, including those that were allegedly extended by conduct or entered into verbally. The Supreme Court noted that the *Kia Motors* case concerned an agreement in writing that contained an arbitration clause and was concluded between Kia and Korea Motors Ltd., and an alleged implied agreement between Kia and Sohnut Mehoniyot, the parent of Korea Motors Ltd., which agreements were in fact one of the same. The Court found that the parent company could not evade the arbitration clause in the written agreement since the parties had accepted, by way of conduct, the provisions of the written agreement. This was a situation, therefore, where a written agreement was applied as a whole to a related third party.

In the present case, by contrast, the issue was not the application of a written contract to a third party or the extension of a written contract by way of conduct, but rather alleged new contracts entered into by the parties with respect to the Projects, which were not included in any previous

agreement and did they contain a written arbitration clause. The Court found that even if a party to a contract included an arbitration clause in previous contracts with the same party, in the absence of a written arbitration agreement applicable to the new contract, that party had the right to choose whether to submit disputes arising from the new contract to arbitration.

The Court therefore accepted Darie's appeal with respect to the Projects, while the remainder of its claims were referred to arbitration in accordance with the District Court's decision.

Commentary

While the Supreme Court's partial grant of Darie's appeal in this case may seem to negate its well-established pro-arbitration approach, the 13-page decision does not necessary signal a change of course for the Israeli courts. There are several aspects of the Court's reasoning that merit particular attention in this regard.

With respect to the "in writing" requirement contained in the Israeli Arbitration Act and the New York Convention, this requirement has been interpreted fairly broadly by the Court in the past, for instance so as to include arbitration agreements sent electronically and not signed by the parties (e.g., *Albex Video Ltd. v. Tyco Building Services Pte Ltd.*). The Court has also considered in such cases the claimant's reliance on, or execution of, the agreements containing the arbitration clauses and the parties' subsequent conduct, as the District Court did in the present case. It should be noted, however, that these cases concerned a written arbitration agreement in some form containing an arbitration clause, whereas in this case the contracts concerning the Projects were allegedly made verbally and the consent to arbitrate was inferred by the District Court from the parties' previous contracts and their relationship as a whole.

Two grounds on which the District Court relied in making this inference were Article 26 of the Israeli Law of Contracts and the Supreme Court's previous decision in the *Kia Motors* case. Regarding Article 26, the Supreme Court's reasoning in finding that this Article does not apply would have benefited from further elaboration, particularly since Israeli courts have relied on other provisions of the Law of Contracts in previous arbitration cases, for instance in support of the severability of arbitration clauses (*Tyco Building Services v. Albex Video Ltd.*). Moreover, the Court's distinction between an agreement containing an arbitration clause that "deals with the parties' general relationship", to which Article 26 presumably applies, and an agreement containing an arbitration clause that "deals with a specific transaction", to which the Article does not apply, arguably fails to provide adequate guidance for lower courts that are faced with more ambiguous situations in which they need to determine the parties' intention to arbitrate. In the present case, for instance, there were both 'general' and 'specific' agreements concluded by the parties, on which the District Court seemed to rely in interpreting their overall relationship and intention to arbitrate.

Regarding the Supreme Court's previous decision in the *Kia Motors* case, it found in that case that the provisions of the written contract between Kia and Korea Motors, including the arbitration clause contained therein, were to be read into the alleged implied contract between Kia and Sohnut Mehoniyot. The District Court interpreted this decision broadly to mean that an established practice of including arbitration clauses in written agreements justified reading such a clause into other, unwritten, agreements between the parties. The Supreme Court, however, interpreted *Kia Motors* more narrowly, emphasizing the overlap between the two agreements and the third party issue in this case. While this distinction may be warranted, the Court again ought to have defined more clearly the factors that lower courts should consider when inferring the parties' intention to

arbitrate from another written contract. The Court in *Kia Motors* seemed to consider such factors as the circumstances surrounding the conclusion of the alleged implied contract and the nature of the relationship between the parties to the written contract, which the Court in the present case did not address.

Adopting a liberal judicial approach to international arbitration does not mean forsaking its founding principles. Rather, in order to protect the integrity of international arbitration and prevent its misuse, it is imperative to safeguard such principles, including that of the consent of the parties. Arguably, this was the principal objective of the Israeli Supreme Court in *Darie v. Alstom*. However, in so doing, the Court ought to have provided more explicit guidance for lower courts that are tasked with resolving increasingly complex questions while attempting to preserve a pro-arbitration judicial tradition.

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