Kluwer Arbitration Blog

Israeli Supreme Court Lost between the Israeli Arbitration Act and the New York Convention

Tamar Meshel (University of Alberta Faculty of Law) · Friday, November 14th, 2014

The dispute in *Siemens AG and Siemens Israel Ltd. v. Israeli Electric Cooperation Ltd.* (3331/14, Supreme Court of Israel Judgment, 13 August 2014) arose out of a request for tenders for the purchase and maintenance of gas turbines issued by the Israeli Electric Cooperation (IEC), following which it entered into several contracts with Siemens Israel and Siemens AG. All of the contracts contained an identical arbitration clause providing for arbitration "to be held as promptly as possible at such place in Israel as may be mutually agreed upon between the parties". In 2013, IEC commenced an action against Siemens in the Israeli District Court, claiming that the contracts were signed as a result of a bribe paid by Siemens to one of IEC's directors. Siemens applied to the District Court to stay the proceedings pursuant to the *Israeli Arbitration Act*, 1968 (IAA) and the arbitration clause contained in the contracts. The District Court refused to grant a stay of proceedings and Siemens applied for leave to appeal to the Supreme Court of Israel.

In its decision to dismiss the request for leave to appeal, the Supreme Court made two disconcerting findings. First, the Court found that the New York Convention did not apply to the parties' arbitration agreement because, even though IEC and Siemens AG were from different countries, they selected Israel as the seat of arbitration. On this basis, the Court concluded that Article 5 of the IAA, which governs domestic arbitration and grants the court broader discretion to refuse to stay proceedings, applied to the dispute, rather than Article 6, which governs foreign arbitrations and generally grants narrower discretion to the courts. Second, the Court found that even if Article 6 were applicable, it allows the courts to refuse to stay proceedings for a "special reason" as provided in Article 5.

With respect to the application of the New York Convention, the Supreme Court applied a restrictive interpretation of what should be considered an 'international' arbitration agreement. While the New York Convention does not define its scope of application with respect to arbitration agreements, it has been said to adopt a "sweeping approach towards arbitration agreements, placing no literal limitation on those agreements that are subject to its…regime" (Gary B. Born, *International Commercial Arbitration*, 2014, at 319). The 'internationality' of an arbitration agreement may result, therefore not only from having a foreign seat, but also, for instance, from the nationality or domicile of the parties or from the underlying transaction. According to well-established international arbitration practice, when determining whether an arbitration agreement that provides for a seat in the forum state falls within the scope of the Convention, the domestic court should apply it if the arbitration agreement has some 'foreign' or 'international' connection (Gary B. Born, *International Arbitration: Law and Practice*, 2012, at 46-47). Although under the

IAA an arbitral award is considered foreign only if it is "made outside of Israel", there is no such requirement where an arbitration agreement is concerned. Therefore, the courts may find an arbitration agreement to be 'international' or 'foreign' even though Israel is also the seat of the arbitration. In finding that the arbitration agreement should be considered to be domestic because the seat of arbitration is Israel, the Supreme Court relied, *inter alia*, on Israeli academic authorities explaining that "the New York Convention applies also to agreements between two Israelis so long as the arbitration is conducted in a foreign country". However, while this requirement applies to arbitration agreements between two Israeli parties, it does not necessarily apply where the arbitration agreement is between an Israeli party and a non-Israeli party.

In the present case, IEC entered into separate contracts with Siemens Israel, an Israeli party, and with Siemens AG, a foreign party. Therefore, while its arbitration agreement with the former may well be considered as domestic, its arbitration agreement with the latter should arguably have been viewed as international. Since the existence of these two contracts raises issues of 'split' proceedings, which in themselves may justify a refusal to grant a stay of proceedings, the Court's pronouncement that the arbitration agreement between IEC and Siemens AG should also be considered as domestic, and that the action against Siemens AG should not be stayed for this reason, seems to add little to the analysis other than potential confusion and a restrictive application of the New York Convention.

With respect to its interpretation of Article 6 of the IAA, the Supreme Court unnecessarily blurred the distinction between Articles 5 and 6. It has long been recognized in Israeli jurisprudence that the courts' discretion to refuse a stay of proceedings under Article 6 is much narrower than under Article 5 and is generally limited to the grounds set out in Article II(3) of the New York Convention. On the facts of this case, a finding that the issues of bribery and fraud underlying the dispute are "incapable of settlement by arbitration" according to Article II(1) of the New York Convention could have sufficed to justify the lower court's refusal to stay the proceedings, without the Court having to pronounce on the, now seemingly unlimited, nature of the courts' discretion to stay proceedings under Article 6. Instead, the Supreme Court not only found that the Israeli courts have discretion to refuse a stay of proceedings under Article 6 of the IAA even where the New York Convention's exceptions do not apply, but also went further to equate this discretion with the much broader discretion granted to the courts under Article 5 by subordinating the former to the latter. The Court found that regardless of which Article an arbitration agreement fell under, Article 5(c), which allows the courts to find there is "special reason" to refuse a stay of proceedings, is fully applicable. This finding of the Court seems overly broad as well as unnecessary in light of its existing discretion to find, as it in fact did, that the subject matter of the dispute is not arbitrable and refuse to stay the proceedings on this basis. It also arguably begs the question of why the Israeli legislature chose to include a separate provision in the IAA regarding stay of proceedings in favor of international arbitrations subject to an international convention, if the ultimate result would effectively be the same as under Article 5.

While the ultimate holding of the Supreme Court may be correct, these pronouncements are disconcerting as they may result in a misunderstanding and misapplication of the New York Convention and Article 6 of the IAA in future stay of proceedings decisions. This is particularly so in light of the Supreme Court's justification of its decision in terms of the rationale underlying the New York Convention. The Court found this rationale to be "the concern that the courts of member states would be reluctant to refer domestic parties to arbitration taking place in a *foreign country*, which could incentivize parties to turn to their own local courts in order to have disputes heard in their preferred forum" (emphasis in original). The Court therefore concluded that "in the present

case it is clear that refusing to stay the proceedings does not undermine this purpose since, under the parties' agreement, the arbitration would have in any event taken place in *Israel*" (emphasis in original). However, the rationale underlying the New York Convention, and presumably also Article 6 of the IAA, arguably extends also to the concern that domestic courts would be reluctant to relinquish their jurisdiction and refer parties to an 'international' dispute to arbitration, regardless of its seat. Accordingly, it has been said that "[t]he purpose of the New York Convention is to promote…the settlement of international disputes through arbitration…With respect to arbitration agreements, the drafters sought to secure that the parties' original intention to have their disputes settled by arbitration would not be frustrated by a subsequent unilateral submission of the dispute to courts." (*ICCA's Guide to the Interpretation of the 1958 New York Convention: A Handbook for Judges*, at 14-15, 36).

This entry was posted on Friday, November 14th, 2014 at 7:50 am and is filed under Arbitration Agreements, International arbitration, Israel, New York Convention
You can follow any responses to this entry through the Comments (RSS) feed. You can skip to the

end and leave a response. Pinging is currently not allowed.