Kluwer Arbitration Blog

# Extension of Arbitration Agreements in Light of the Croatian Supreme Court Ruling – Caution with Pro-Arbitration Approach

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An extension of arbitration agreements to non-signatories has been a much discussed topic, also on this blog. Here is an insight from Croatian courts:

In a judgment issued on 2 September 2014 (VSRH Revt-321/2013-2), the Croatian Supreme Court ["Court"] set aside an arbitral award rendered by the Permanent Arbitration Court at the Croatian Chamber of Economy in Zagreb. The Court thereby altered the lower instance judgments of the Zagreb Commercial Court and the High Commercial Court, which had both upheld the award. The application for setting aside the award was filed on the grounds that

- there was no arbitration agreement, or that it was invalid (Art 36 para 2 point a) of the Arbitration Law)
- the award dealt with a dispute not contemplated by the arbitration agreement (Art 36 para 2 point d) AL).

The dispute concerned a ship remount contract concluded in 1996 between Shipyard K. Ltd, the Contractor, and T.P., the Employer. The parties agreed to submit all disputes arising from the said contract to the Permanent Arbitration Court at the Croatian Chamber of Economy in Zagreb and chose Croatian law to be applicable to the dispute.

In 1997 the same parties concluded an annex to the contract regarding additional works and their payment. A third party, the Slovenian shipping agency C. K. Ltd also signed the annex committing itself as a guarantor for the entire debt. The exact wording of the relevant clause was: "*The Employer T.P. and C.K. are jointly and severally liable for the payment of the performed works, whereby C.K. commits as a subsidiary guarantor for the entire debt.*" The annex did not reiterate the arbitration clause from the main contract, but contained a clause which read: "*All the other conditions remain unchanged.*"

Prior to resorting to arbitration, Shipyard K. sued C.K., the Slovenian guarantor, before the Commercial Court in Rijeka, but that court declared itself incompetent and refused to hear the case. In the arbitration proceedings which took place thereafter, the arbitral tribunal accepted the claim brought against C.K., and awarded remuneration to Shipyard K.

C.K., the guarantor, filed a motion for setting aside the award with the Commercial Court in

Zagreb, and subsequently appealed to the High Commercial Court. It was disputed during these lower instance court proceedings whether C.K. as a guarantor also accepted the arbitration clause from the original contract. While dismissing the motion, the lower courts held that the guarantor by accepting the guarantee commitment for all the duties from the ship remount contract (which included the arbitration clause) also accepted that the said arbitration clause be applied to the guarantee. They argued that the guarantor knew or should have known the entire content of the contract to which it was acceding to, especially since it was clearly stated that all the other contract conditions remain unchanged. The courts concluded that the arbitration clause stayed in force by signing the said annex, thus extending it to C.K, the guarantor.

Seized of the Claimant´s appeal against the lower instance judgments, the Croatian Supreme Court held that the lower courts misapplied the law concerning the existence of the arbitration agreement between the Shipyard and the guarantor, and consequently ruled that the requirements for setting aside the award were fulfilled. The Supreme Court found that there were two separate legal transactions contained in the annex: one being the annex to the ship remount contract, and the other independent transaction being the guarantee agreement whereby the guarantor committed to fulfil the debtor´s (Employer´s) contractual obligation. Contrary to the view expressed in the contested award, the Supreme Court held that those two agreements (service agreement and guarantee agreement) were not functionally connected to the extent that they would form a unity in a way that the guarantor, by signing the guarantee accepted all the conditions from the original contract, including the arbitration clause.

The Supreme Court went on to determine that the clause "*All the other conditions remain unchanged*." solely concerns the ship remount contract and not the guarantee agreement, regardless of the fact that it follows immediately after the guarantee clause. The Court considered that even if it could be determined that the guarantor agreed with the said clause, it would have only meant that it did not oppose having the disputes between the Employer and Shipyard K. resolved by arbitration. Consequently, the award was set aside on the grounds that there was no arbitration agreement.

The case shows divergent approaches taken by Croatian courts to the extension of arbitration agreements in a narrow sense and the general validity of arbitration agreements. The lower courts adopted a pro-arbitration approach when interpreting the guarantee, whereas the Supreme Court did not show such inclination and rather resorted to rather restrictive interpretation.

Firstly, although the analysed judgment does not provide details about the relationship between the guarantor and the main debtor, it is known that the guarantor was a Slovenian shipping agency, thus a business company. Such constellation may call for consideration whether the guarantor also benefitted from Shipyard K.´s performance under the ship remount contract. If yes, then such guarantor´s assumption of rights (beside the payment obligation) may corroborate the extension of the arbitration clause.

Secondly, given the inexact wording of the annex provisions, it is difficult to determine whether the guarantee clause "*All the other conditions remain unchanged.*" might qualify as a reference incorporating all the terms of the main contract. However, such interpretation exercise might be facilitated by implying guarantor´s consent to the arbitration clause considering its execution of the annex with multiple references to the main contract.

Thirdly, the guarantor´s consent to arbitrate might be inferred from its contractual role and the

nature of the guarantee. It is obvious that the annex containing the guarantee was drafted specifically for the purpose of the ship remount contract, and it is fair to assume that the shipping agency had a commercial interest and thus significant role in performance of the underlying ship remount contract. It is further unlikely that an international shipping agency would adhere to a contract in the way it did, without being aware of its content. The Supreme Court´s argument that the guarantor´s possible agreement with the provision that "*All the other conditions remain unchanged*." only meant that it did not oppose having the disputes between the Employer and the Contractor resolved by arbitration, remains in this regard questionable. It is hence unclear how any opposition to the arbitration clause would (could) have actually affected the validity thereof.

Lastly, the described constellation is indicative of parties´ intention that the guarantor becomes a party to the arbitration agreement. Clearly, the tribunal and three court instances were of such view.

There are two cases with comparable factual scenarios: the Swiss Federal Court case 4A_128/2008 and the English High Court case *Stellar Shipping Co LLC v Hudson Shipping Lines*. In the former, a guarantor was considered to be bound by an arbitration agreement entered into solely by the original debtor and his creditor, only if he assumed joint liability with the debtor. The Swiss Court upheld the award on jurisdiction and refused to extend the application of the arbitration agreement to a guarantor.

In *Stellar* case, on the other hand, the English Court upheld the award confirming the tribunal´s view that a guarantor who endorses a contract is generally bound by the arbitration clause contained in the contract. The Court held that "*it is commercially sensible because the parties were entering into a tri-partite relationship (…) and would reasonably be expected to intend that all disputes arising out of that relationship be dealt with in a like manner.*"

Clearly, the Croatian Supreme Court took the stance which is more in line with the Swiss decision, however, putting the commercial sensibility in second place.

The correctness of this ruling may be examined from various angles. Not only does it encourage parallel proceedings arising out of guaranteed obligation, but it also ignores the fact that the Shipyard tried to litigate the same claim back in 1998, when the Commercial Court denied its jurisdiction and that decision had been final when the arbitration was started. Thus, the Court gave priority to the narrow construction of the arbitration clause over principle of procedural economy and commercial rationality. On the other hand, Shipyard K. (which, in the meantime, went bankrupt) is after fifteen-year long pursuit of its claim again at the beginning.

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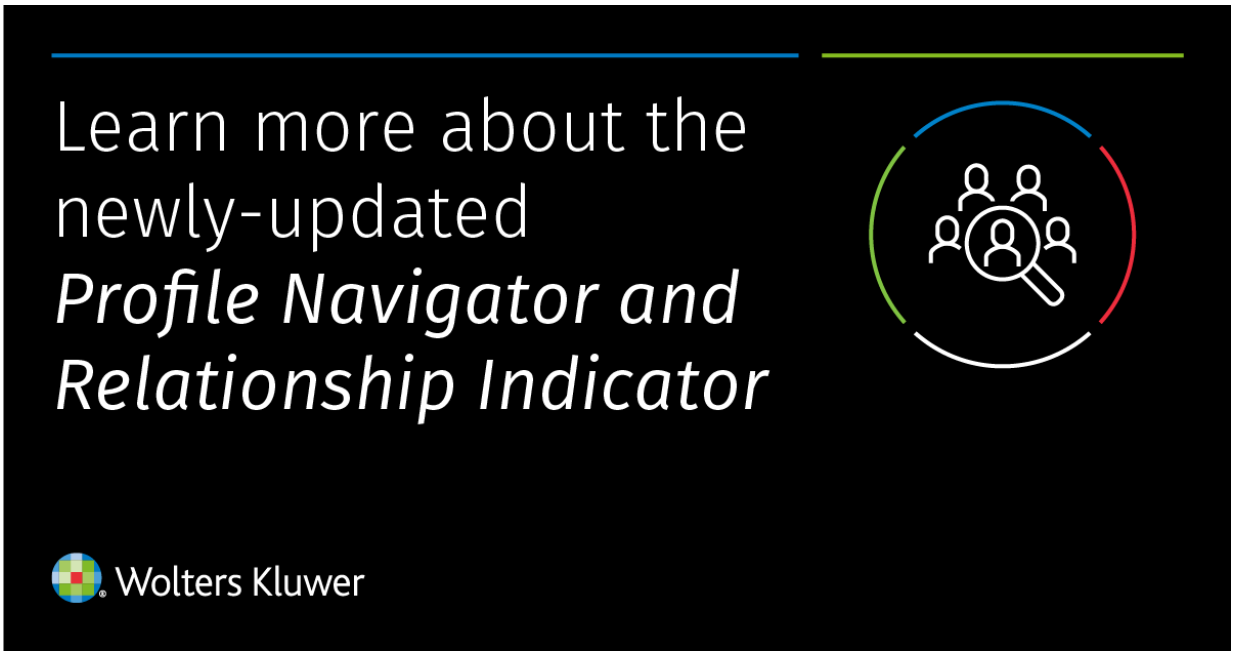


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