Extension of arbitration agreement to non-signatory upheld under New York Convention (Swiss Supreme Court)

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In *decision 4A_646/2018*, the Swiss Supreme Court confirmed a state court judgment, in which the court had extended an arbitration clause to a non-signatory and referred the dispute to arbitration by virtue of Article II(3) of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958.

Speedread

In a recently published German-language decision, slated for publication in the official court reporter, the Swiss Supreme Court upheld a judgment in which a lower court extended an arbitration agreement to a non-signatory because it had intervened in the performance of the main agreement. Moreover, the lower court had also held that an arbitration agreement may be "tacitly prolonged". Accordingly, the lower court declined jurisdiction to hear the claims brought before it and referred the parties to arbitration in accordance with Article II(3) of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (NYC).

The case concerned a distribution agreement containing an arbitration clause, between two companies. In practice, a sister company (defendant) of the distributor, which was not a signatory to the distribution agreement, performed the agreement and went on to do so beyond the agreement's initial term. The principal (petitioner) sought payment of the allegedly outstanding amounts from the defendant before the court of competent jurisdiction. The defendant raised an arbitration defence and the principal argued that the defendant was not bound by the arbitration clause given that it did not sign the distribution agreement. In addition, the principal alleged that the tacit prolongation of the term of the distribution agreement did not entail the prolongation of the arbitration clause on the grounds that the latter was separate and independent from the distribution agreement.

In a landmark ruling, the Supreme Court held that where a non-signatory party is involved in the performance of an agreement and shows, by its conduct, that it intends to be party to the agreement and the arbitration clause, an arbitration clause can bind non-signatories under Article II of the NYC. Furthermore, the Supreme Court found that the formal requirements of Article II(2) of the NYC were not a bar to a tacit prolongation of the agreement and the arbitration clause contained therein. (*Decision 4A_646/2018 (17 April 2019) (Swiss Supreme Court).*)

Background

Article II of the New York Convention (NYC) provides that:

> "1. Each Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration.
>
> 2. The term "agreement in writing" shall include an arbitral clause in a contract or an arbitration agreement, signed by the parties or contained in an exchange of letters or telegrams.
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> 3. The court of a Contracting State, when seized of an action in a matter in respect of which the parties have made an agreement within the meaning of this article, shall, at the request of one of the parties, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed."

For further information on the New York Convention, see *Practice note, Enforcing arbitral awards under the New York Convention 1958: overview*.

Article 178 of the Swiss International Law Act (PILA) reads as follows:

> "1. The arbitration agreement must be made in writing, by telegram, telex, tele-copier or any other means of communication which permits it to be evidenced by a text.
>
> 2. Furthermore, an arbitration agreement is valid if it conforms either to the law chosen by the parties, or to the law governing the subject-matter of the dispute, in particular the main contract, or to Swiss law."

For further information on arbitration in Switzerland, see *Practice note, Arbitration in Switzerland*.

Facts

A Slovenian company (as principal) (A) and a Swiss company (as distributor) (BAG), signed a distribution agreement on 9 October 2009 whereby A was to deliver food products to BAG, who in turn, was to market them in Switzerland (Agreement).

On 9 October 2009, a member of BAG's board (C), who was vested with individual signing authority, had signed the Agreement on behalf of BAG. At the same time, C was also a member of the board of B. Suisse SA (BSSA), a sister company of BAG. C also had individual signing authority in respect of BSSA.

However, in practice, BSSA (and not BAG) performed BAG's obligations under the Agreement.

The Agreement was governed by Slovenian law and included an arbitration clause providing for arbitration in Ljubljana (Slovenia).

In accordance with its terms, the Agreement was initially to expire on 31 December 2014. The parties discussed a potential new agreement during the second half of 2014. Following failed negotiations, the parties continued their business relationship and complied with their obligations under the Agreement also throughout 2015. The business relationship between the parties eventually ended at the end of 2015.

In May 2016, A initiated court proceedings against BSSA in Switzerland aimed at recovering allegedly outstanding amounts. In response, BSSA raised a procedural objection requesting the court to declare A's claims as inadmissible on the grounds that the parties had entered into an arbitration agreement and that an arbitral tribunal seated in Ljubljana had jurisdiction with regard to any dispute.

The court found that it lacked jurisdiction to hear A's claims against BSSA and referred the parties to arbitration pursuant to Article II(3) of the NYC.

As BSSA had performed the Agreement for several years, the court found that it should be construed as manifesting BSSA's intent to be bound by the Agreement, as well as by the arbitration clause, in BAG's stead. Moreover, the court found that A's argument that BSSA was not bound by the arbitration clause given that it did not sign the Agreement infringed the principle of good faith (*venire contra factum proprium*). This was because A had:

- Actively contributed to BSSA's performance of the Agreement in spite of the fact that it allegedly did not sign it.
- First submitted in its statement of claim that the Agreement had been entered into by A and BSSA, but upon BSSA raising the plea that an arbitration agreement had been concluded, invoked that the formal requirements of the arbitration clause were missing since BSSA supposedly failed to sign the Agreement, as required under Article II(2) NYC.

Finally, the court considered that once the term of the Agreement had expired, the parties had engaged in conduct that constituted a tacit prolongation of both the Agreement and the arbitration clause contained therein. As a result, the court declared A's claims as inadmissible and referred the parties to arbitration.

A subsequently appealed to the Supreme Court to vacate the lower court judgment, arguing that BSSA was not bound by the arbitration clause and that the lower court had violated Article II(2) of the NYC. In connection with the tacit prolongation of the arbitration clause, A objected that, by virtue of the principle of separability, the legal fate of the arbitration clause was independent from that of the Agreement.

Decision

The Supreme Court dismissed the appeal against the lower court judgment, concluding that the lower court was correct to decline jurisdiction and refer the parties to arbitration pursuant to Article II(3) of the NYC. However, the Supreme Court did not confirm the lower court's reasoning and outlined its own legal reasons in its judgment.

The Supreme Court initially considered (obiter) that the lower court erred in its factual findings when it found that the Agreement had bound A and BAG. It recalled that the determination of who the parties to an arbitration clause are is a matter of contract interpretation. Under Swiss law, the true and common intent of the parties must be given precedence over the black letter of a contract. Assuming that the true and common intent of the parties from the outset was, despite an inaccurate or incomplete party designation in the Agreement, to bind A and BSSA, the lower court should have found that there was a valid arbitration clause pursuant to Article II(2) of the NYC, not least because C, who signed the Agreement, was also an authorised party representative of BSSA. As a result, the Supreme Court considered that the lower court had failed to examine in further detail whether there already was a meeting of minds between A and BSSA at the time the Agreement was concluded.

Despite these shortcomings, the Supreme Court decided not to remand the case to the lower court for consideration pertaining to procedural economy and since a valid arbitration clause binding A and BSSA existed anyway, based on the practice of the intervention in the agreement's performance.

The Supreme Court then proceeded to examine the following topical issues:

- Whether BSSA was bound by the arbitration agreement for the purposes of Article II of the NYC and by virtue of what legal doctrine. (Issue One).
- Whether an arbitration clause could be tacitly prolonged alongside the main agreement under Article II of the NYC (Issue Two).

Issue One: Intervention in the performance of the distribution agreement

The Supreme Court found that BSSA had intervened in the performance of the Agreement for several years, and that, through such conduct, it had accepted to be bound by the arbitration clause contained in the Agreement. In particular, citing previous case law (see *Decision 121 III 38*, paragraph 2c), the court pointed out that the formal requirements in Article II(2) of the NYC correspond to that of Article 178(1) of the PILA. Therefore, it was justified to apply its established case law precedent, on the question of extension of arbitration agreements to non-signatories who participated in the performance of the agreement, to cases in the context of Article II of the NYC. That was so, even though such precedent had been rendered in relation to Article 178 PILA (see *Decision 129 III 727*, paragraphs 5.3.1 and 5.3.2).

A had argued that Article 178(1) of the PILA allegedly contained a lower standard of formal requirements than those contained in Article II(2) of the NYC. The NYC stipulates that an arbitration agreement should be "signed by the parties", whereas there is no such corresponding requirement in Article 178(1) PILA. The court dismissed this argument and held that its longstanding practice, whereby the formal requirements set out in Article 178(1) of the PILA only apply to the initial parties to the arbitration agreement, but not to third parties (see *Decision 129 III 727*), should similarly apply to Article II(2) of the NYC. This was the case here, since BSSA was not specifically named in the Agreement, but adhered to it later on.

Finally, the court noted that, as regards the substantive validity of the arbitration clause, it is to be established in accordance with the substantive law applicable to the arbitration clause, that is, in the present case, by Slovenian law. However, the court pointed out that A failed to demonstrate that such an extension of the arbitration clause to a third party would not have taken place under Slovenian law. On the contrary, the court held that A's objections were limited only to the lack of formal validity of the arbitration clause under Article II(2) of the NYC, which had proven to be unfounded.

Issue Two: Tacit prolongation of the arbitration clause

The court held that A failed to establish that the lower court would have made an arbitrary application of Slovenian law when it found that the parties had tacitly prolonged the Agreement and the arbitration clause set out therein. Further, the court pointed out that, even assuming an arbitrary application of Slovenian law, A did not demonstrate that the lower court would have denied the prolongation of the arbitration clause based on Slovenian law. Finally, as concerns A's argument that the prolongation of the arbitration clause was not valid from the formal standpoint of Article II(2) of the NYC because it only occurred impliedly, the court considered that the lower court's reasoning was not open to criticism. Indeed, according to the court, the lower court rightly found that no formal prerequisite was necessary for a mere prolongation of an arbitration clause under Article II(2) of the NYC.

Comment

The decision is noteworthy in a number of respects.

First, the Supreme Court has ruled for the first time that it would apply its previous case law on the extension of an arbitration clause to non-signatory third-parties (only previously issued in relation to Article 178 of the PILA - see *Decision 129 III 727*) also in relation to Article II of the NYC. In particular, the Supreme Court clarified that such extension can arise, under certain circumstances, on the basis of the participation of a non-signatory in the performance of an agreement, besides the more classic examples of assignment, succession or agency (see *Decision 134 III 565*, paragraph 3.2).

Second, the decision is of interest for the holding that Article II of the NYC does not constitute any bar to an implied prolongation of an arbitration clause by the parties' conduct.

More generally, the present decision of the Supreme Court is to be welcomed as it constitutes a further demonstration of the continued pro-arbitration stance of the Swiss judiciary at all levels.

Lastly, the efficiency of the Supreme Court's decision-making process deserves mention. The proceedings, which included two rounds of written submissions, lasted only five months from the date of the petition to annul the judgment to the Supreme Court's ruling. This short timeframe cements the Supreme Court's reputation as a comparatively efficient jurisdiction.

Case

Decision 4A_646/2018 (17 April 2019) (Swiss Supreme Court).

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