

Swiss Supreme Court sets aside award extending jurisdiction to non-signatory on basis of implied consent

by *Practical Law Arbitration*, with *Schellenberg Wittmer Ltd*

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In *Decision 4A_124/2020*, the Swiss Supreme Court upheld an application to set aside a partial final award on jurisdiction by an ICC arbitral tribunal that had extended an arbitration agreement to a non-signatory.

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Anya George, ACI Arb (Partner) and Daniil Vlasenko, LL.M. (Associate), Schellenberg Wittmer Ltd

In a recently published German-language decision to be published in the official register, the Swiss Supreme Court set aside a partial final award on jurisdiction rendered by an ICC arbitral tribunal.

The underlying dispute arose out of the construction and operation of power plants, involving a supplier and subcontractor, both incorporated in South Korea, and purchasers, incorporated in Singapore and Bangladesh. The supplier subcontracted the delivery of diesel engines for the plant to a subcontractor. Several technical problems occurred after the installation of the engines. Following many unsuccessful attempts to find a solution through technical investigations and negotiations, the purchasers refused to comply with their payment obligations under the supply contracts.

The supplier initiated ICC arbitration against the purchasers, based on the identical arbitration agreement contained in the supply contracts.

The purchasers subsequently requested that the subcontractor be included as a party to the arbitration. The subcontractor disputed the jurisdiction of the ICC tribunal.

The tribunal decided to bifurcate the proceedings in order to address the issue of jurisdiction over claims against the subcontractor at the outset. In its partial final award on jurisdiction, the ICC tribunal found that it had jurisdiction over the subcontractor based on the implied consent doctrine.

The subcontractor consequently filed an application to set aside the award with the Swiss Supreme Court.

The court granted the application, finding that while the subcontractor played an important role in the relationships between the supplier and the purchasers, its actions could not qualify as an expression of implied consent to be bound by the arbitration clause. Therefore, the ICC tribunal had no jurisdiction to hear claims against the subcontractor on that basis. (*Decision 4A_124/2020 (13 November 2020)*.)

Background

Private International Law Act (PILA)

Article 190(2) of the PILA provides an exhaustive list of grounds on which the Swiss Supreme Court can set aside an international award including if the award is incompatible with public policy (*article 190(2)(e)*).

Article 190(3) of the PILA provides that "preliminary awards can be annulled on the grounds of the above paras. 2(a) and 2(b) only [...]".

In turn, Article 190(2)(a) and (2)(b) of the PILA provides that the award may be annulled: "if the sole arbitrator was not properly appointed or if the arbitral tribunal was not properly constituted", and "if the arbitral tribunal wrongly accepted or declined jurisdiction".

Facts

In 2009, due to an electricity shortage, the government of Bangladesh permitted the construction and operation of privately-owned power plants. A dispute arose between several entities involved in the building and operating of one of those diesel power plants. AB (Supplier) entered into several contracts with a group of companies including C, D, EE, EF, EG and H (Purchasers) regarding the construction and delivery of the plant, and the supply of electricity. The Supplier subcontracted the delivery of the diesel engines for the plant to AA (Subcontractor). The Supplier and the Subcontractor were both incorporated in South Korea and the Purchasers were incorporated in Singapore and Bangladesh (together, the Parties).

In July 2010, the Supplier entered into a Contract with the Purchasers for the design, procurement, construction and delivery of a diesel power plant, for a consideration of approximately USD 24 million (Main Contract).

In November 2010, the Supplier and the Subcontractor concluded a separate contract, under which the latter agreed to supply seven diesel engines for a consideration of approximately USD 12 million. Subsequently, the diesel engines were delivered to the Purchasers and installed by the Subcontractor.

In July 2011, the Purchasers informed the Supplier of technical problems and requested appropriate action. Later that month, the Supplier replied that it had contacted the Subcontractor and together they would "jointly guarantee" the quality of the engines.

In December 2011, the former President and CEO of both the Supplier and the Subcontractor wrote a joint letter on behalf of both companies describing the steps to be taken to solve the problems.

In August 2012, the Subcontractor unilaterally communicated with the Purchasers and requested to be provided with the defective parts of the engines to determine the cause of the defect.

In February 2014, the Parties held a number of meetings to discuss further technical issues but failed to resolve them. As a result, the Purchasers refused to make further payments to the Supplier under their respective contracts.

In March 2018, the Supplier initiated arbitration proceedings under the ICC Rules against the Purchasers. The Purchasers requested to join the Subcontractor as a party to the arbitration proceedings.

In January 2020, the ICC tribunal delivered a partial final award on jurisdiction and found that it had jurisdiction to hear the claims brought by the Purchasers against the Subcontractor under the Main Contract.

The ICC tribunal examined whether an extension of the arbitration agreement could result from the Subcontractor's involvement in the conclusion and execution of the Contract, that is, whether such involvement could be seen as evidence of implied consent to the arbitration clause, based on the principle of good faith.

The Purchasers submitted evidence that the Subcontractor was actively involved in the conclusion and execution of the Contract, including:

- Participation in numerous meetings with the Purchasers, including in a meeting before the conclusion of the Main Contract.
- Several joint emails on behalf of both the Supplier and the Subcontractor.
- Active involvement in the engine test runs.
- Engineers employed by the Subcontractor attended the site and tried to solve the technical issues.
- The Subcontractor directly communicated with the Purchasers about the issues connected to the engines.

The ICC tribunal found that these circumstances, taken separately, would not be sufficient to extend the arbitration agreement to the Subcontractor. However, seen as a whole, they led to the conclusion that the Subcontractor did indeed participate in the conclusion and performance of the Main Contract to such an extent that the contracting parties could in good faith have assumed that the Subcontractor intended to be bound by the arbitration agreement.

The ICC tribunal considered it significant that one of the essential technical documents of the Contract originated from the Subcontractor. In particular, the Contract stated that the Supplier had agreed to sell and deliver the engines in accordance with the specifications provided by the Subcontractor.

Finally, the ICC tribunal found that the Subcontractor was aware of the terms of the arbitration agreement since it had participated in the conclusion of the Contract.

In reaching its decision, the tribunal did not find that there was actual agreement between the Parties that the Subcontractor should be bound by the arbitration agreement, but rather that an extension of the arbitration agreement was justified based on an interpretation of the Subcontractor's conduct in accordance with the principle of good faith.

The Subcontractor filed a setting aside application with the Swiss Supreme Court, seeking the annulment of the ICC tribunal's decision on jurisdiction based on articles 190(3) and 190(2)(b) of the PILA. The Subcontractor argued that it had not consented to the arbitration agreement and that the ICC tribunal had wrongly accepted jurisdiction.

Decision

The Swiss Supreme Court granted the Subcontractor's application and set aside the award on jurisdiction. It found that, whilst the circumstances described by the ICC tribunal did demonstrate a degree of involvement by the Subcontractor in the performance of the Main Contract, it was not convinced that this involvement was sufficient to constitute implied consent to be bound by the arbitration agreement in that contract.

As a general remark, the Swiss Supreme Court underlined the importance of the doctrine of privity of contract, but recalled its case law according to which an arbitration clause can be extended to a non-signatory if its active involvement in the performance of the contract can be understood as implied consent to be bound by the arbitration clause.

The court considered that the roles of the respective Parties were contractually defined: the Subcontractor sold the diesel engines to the Supplier, but the latter was the only one to have entered into a contractual relationship with the Purchasers. It was not surprising that the Subcontractor played a central role in the performance of the Main Contract, since it provided the Purchaser with an essential component of the diesel power plant. The Swiss Supreme Court stated that the actions that the Subcontractor took to resolve the problems with the diesel engines stemmed directly from its obligations as a subcontractor; it was required to carry out warranty repairs. On this front, the Swiss Supreme Court found that the responsibilities of the Supplier and the Subcontractor did not mix, because the Subcontractor's responsibilities were limited to the issues connected to the diesel engines. Therefore, the Purchasers had to be aware that the Subcontractor was not a party to the Contract. Moreover, the fact that the Supplier and the Subcontractor were affiliated and had, for a brief time, been under the same management, was not sufficient to create any appearance that they were "commingled", as they were always clearly distinguishable as individual entities.

The Swiss Supreme Court therefore concluded that the evidence submitted by the Purchasers and used by the ICC tribunal in its award could not be understood as an expression of the Subcontractor's implied consent to agree to the arbitration agreement, and it set aside the award on that basis.

The ICC tribunal had left open the question of whether it could accept jurisdiction over the Subcontractor on the basis of an assignment of contractual duties from the Supplier to the Subcontractor but had failed to make any factual findings in that regard. The Supreme Court therefore remanded the matter back to the tribunal for it to decide on this issue.

Comment

This decision provides an important addition to the case law of the Swiss Supreme Court with regard to the extension of arbitration agreements to non-signatories and in particular the doctrine of implied consent.

The Supreme Court clearly distinguished this case from an earlier matter in which it had found that the involvement of a third party in the performance of the contract amounted to implied consent to the arbitration agreement. In that case, the third party (an individual) had no contractually defined role in a construction project, but had influenced the management of two of the parties involved in the project, which was being carried out on his own land.

Although this decision is fact-specific and it would be unwise to seek to draw too broad a conclusion from the court's ruling, it should provide a degree of comfort to subcontractors that they will in principle not be deemed to have given implied consent to an arbitration clause in the main contract simply by virtue of having performed their obligations under the subcontract.

Case

Decision 4A_124/2020 (13 November 2020) (Swiss Supreme Court).

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