Extension of Arbitration Agreements to Non-Signatories

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1. Introduction

(1) Few topics have received as much attention as the extension of arbitration agreements to non-signatories. This results less from the undeniable practical significance or complexity of this issue than, as will be seen, from the fact that it touches upon some of the canons of arbitration, such as, e.g. its consensual basis or that the arbitration agreement be in writing.

2. Definition

(2) "Extension of the arbitration agreement to non-signatories", the expression most used, covers situations in which a party's standing to sue or to be sued under an arbitration agreement is considered, whenever this party is not named or designated in the arbitration agreement or the contract containing it, or appears to have signed the arbitration agreement or the contract on behalf of a third party.

(3) Two points are worth making at this juncture.

(4) First, the word "signatory" - which is a reminiscence of the (not so old) times when the arbitration agreement had to be signed to be valid - does not accurately reflect the issue. Indeed, under the New York Convention (Article II(2)) and under most domestic arbitration laws, such as, e.g., Chapter 12 of the Swiss Private International Law Act ("PILA"), the requirement that the arbitration agreement be *signed* is not an absolute one anymore. Since 2000, UNCITRAL's Working Group on Arbitration has been considering possible amendments to the writing requirement in Article 7(2) of the Model Law, including one which consisted in the mere deletion of this sub-section. It is therefore improper and slightly misleading to refer to the extension of the arbitration agreement to *non-signatories*.

(5) Second, "extension" of the arbitration agreement does not cover all situations in which the issue of the subjective scope of the arbitration agreement arises. Indeed, whereas "extension" relates to situations in which a third party becomes party, willingly or not, to an existing arbitration agreement, it does not comprise the situation in which a third party replaces one of the original parties to the arbitration agreement, which arises when a contract containing an arbitration agreement is

transferred to a third party, as a result of a contract assignment, a merger of companies or inheritance law.

(6) "Transfer" of the arbitration agreement, on the one hand, and "extension", on the other, raise different issues. In case of transfer, the main issue is whether the arbitration agreement is transferred together with the main contract containing it. This question is in principle answered in the affirmative under Swiss law on the ground that whereas the arbitration agreement is severable from the main contract, it is not necessarily independent from it (see for instance the decision of the Federal Tribunal 4P.126/1992 of 13 October 1992, reported in ASA Bull. 1993, pp. 68 ff). In cases where it comes to extend an arbitration agreement to a third party, the decisive element is whether such third party consented to it, so that it is bound by it. Thus, consent is decisive.

(7) Both situations have in common that they directly concern the jurisdiction of the arbitral tribunal.

3. Consent is of the essence

(8) Arbitration is consensual by nature. Indeed, the arbitrators' jurisdiction derives exclusively from the parties' agreement to use arbitration as a means to resolve their disputes. As a corollary, the jurisdiction of the arbitrators only extends to those that are privy to the arbitration agreement.

(9) Determining whether jurisdiction extends to a party comes down to determining whether this party is privy to the arbitration agreement. While it has some very specific features, an arbitration agreement is a contract and this determination will usually be made in accordance with the general rules governing formation of contracts under the relevant law. Under most national laws, the central issue will thus be whether the third party suing or being sued under the arbitration agreement consented to it.

(10) Under Swiss law, for instance, it is commonly admitted that the question whether a third party is bound by an arbitration agreement is an issue of contract law - and, more specifically, a matter of contract formation - which must be resolved under Articles 1 ff of the Swiss Code of Obligation, in particular Article 18.

(11) Reduced to its core, the determination of who the parties to an arbitration agreement are is equivalent to the determination of which parties have consented to it or, as the case may be, of which parties should be barred from relying on an apparent lack of consent.

4. Two main views are advocated

(12) It may be observed that courts, arbitrators and legal authors advocate two main approaches.

(13) According to the first approach, which may be referred to as the conservative one, the scope of an arbitration agreement may only be extended under very specific circumstances. The consent of the third party to be bound by the arbitration agreement should be clearly established. An argument often raised in support of this view is that, by entering into an arbitration agreement, a party waives its right, perhaps of constitutional rank, to seek recourse to its "natural" judge.

(14) Under the second approach, much more liberal, a third party will be deemed to be bound by an arbitration agreement in many circumstances, including by the mere fact that it took an active and substantial part in the negotiation or performance of the main contract, which gives rise to the presumption that it was aware of the arbitration agreement. Whereas in the first approach the focus is on a subjective interpretation, this approach concentrates on purely objective criteria. Its advocates emphasize that arbitration is gradually becoming the ordinary way to solve commercial disputes or yet, that fairness or the good administration of justice, in particular the need to avoid the multiplication of parallel proceedings, justifies that extension be admitted freely.

5. The law applicable to the determination of the parties who are bound by the arbitration agreement

(15) As stated above, the question whether someone is bound by an arbitration agreement touches upon the substantive validity of that agreement.

(16) Under Swiss law, the substantive validity of the arbitration agreement will be determined under either of the law chosen by the parties to govern the arbitration clause (which is hardly ever done), the substantive applicable law, or Swiss law (Article 178(2) of the PILA).

(17) In considering that the question of the subjective scope of an arbitration agreement is as a matter of substantive validity to be determined primarily by the law governing the contract or the law applicable to the arbitration agreement itself, Swiss law is representative of the solution prevailing in most legal systems.

(18) French courts, on the other hand, have inferred from the principle that the arbitration agreement is autonomous from the main contract that the arbitration agreement is valid absent any reference to a legal order - including the French one - if the seat of the arbitration is in France. They have thus reached the conclusion that the validity

of an arbitration agreement must be ascertained irrespective of any national law, solely according to the parties' common intention, and only subject to international public policy. As will be seen below, this reference to the sole intention of the parties together with the absence of any requirement of form has contributed to the development of French's very liberal case law regarding extension of arbitration agreements.

(19) Some national laws also contain substantive rules of private international law which govern the validity of arbitration agreements irrespective of any conflict of laws rules. Under Swiss law, this is the case for the *formal* validity of the arbitration agreement, which is governed by a substantive rule of private international law in Article 178(1) of the PILA.

6. Circumstances under which an arbitration agreement may be extended to non-signatories

6.1 Extension with the third party's oral or tacit consent

(20) The extension of an arbitration agreement to which the third party expressly consented in writing raises no particular difficulty.

(21) The situation is different when the third party expressly consented to the arbitration agreement, but did so orally. Leaving aside difficulties in proving an oral consent, the issue becomes whether the law governing the validity of the arbitration agreement requires that such consent be in writing or, as French law - and, since recently, Swiss law - does not provide for any requirement of form. In the latter case, express oral agreement is sufficient for the third party to be bound by the arbitration agreement.

(22) It is hardly possible to make a list of situations in which a third party will be deemed to have *tacitly* consented to an arbitration agreement, i.e. the situations in which consent may be inferred from its conduct. Obviously, a third party suing on the basis of an arbitration agreement will be deemed to have consented to it. On the other hand, one can reasonably consider that, under most national laws, including Swiss law, the active and substantial participation of a third party in the negotiation or performance of a contract containing an arbitration agreement is not, in and of itself, sufficient for the third party to be deemed bound by the arbitration agreement. There must be certain specific circumstances from which the third party's consent to the arbitration agreement may inferred. By way of example, one may think of a party, co-defendant in *court* proceedings, which, together with its co-defendant, relies on the arbitration agreement entered into by the latter the plaintiff to challenge the

jurisdiction of the court. If the plaintiff then initiates arbitration proceedings against the two co-defendants, the one that is not a party to the arbitration agreement will be barred from raising this objection to challenge the jurisdiction of the arbitral tribunal (in such circumstances, the third party's objection would, in fact, be nearly tantamount to an abuse of right or, in common law countries, would probably fall under the doctrine of estoppel). Under French law, in accordance with a case law inaugurated in the *Dow Chemical v. Isover-Saint-Gobain* case, a parent company will be deemed to be bound by an arbitration agreement entered into by one of its subsidiaries if the parent company appears to be chiefly concerned by the contract and any disputes that may arise in its connection. The group of companies doctrine which underlines this case law has not been endorsed in the Swiss legal system. Hence, an arbitration agreement entered into by a subsidiary will not bind its parent company unless certain circumstances justify that the very independence of the subsidiary as a corporate body be disregarded (piercing of the corporate veil). This will however require a finding that the parent company's reliance on its independence is abusive.

(23) As pointed out above, French case law holds an arbitration agreement to be valid provided only that it reflects the common intention of the parties. This has fostered the development of very liberal case law, which started in the *Dow Chemical v. Isover-Saint-Gobain* case and culminated in a decision of the Cour d'Appel de Paris of 1995, in which the court held, in substance, that the self-standing validity of an arbitration agreement in an international contract requires that its scope be extended to parties which are directly implicated in the performance of the contract and in the disputes that may arise therefrom, as long as it is established that their situation and activities gives rise to the presumption that they were aware of the existence and the scope of the arbitration agreement, even though they were not named in the contract containing it. Whereas this case law was originally limited to the extension of arbitration agreements to companies of a group under the justification that a group should be viewed as a whole, according to the economic reality, courts and arbitral tribunals have been prompt to free themselves of this obstacle and apply it in other cases as well.

(24) It is noteworthy that whether the third party is suing or is being sued under an arbitration agreement makes no difference in principle (in the *Dow Chemical v. Isover-Saint-Gobain* case, Dow Chemical, the plaintiff, was not bound by the arbitration agreement). As a matter of pure logic, however, it is submitted that it is less problematic for a third party to compel arbitration against a party to an arbitration agreement than for a party to an arbitration agreement to compel

arbitration against a third party. In the former case, indeed, the party to the arbitration agreement will be barred from asserting that it did not consent to arbitration as a means to resolve disputes. It could argue, however, that it consented to arbitration *intuitu personae*.

6.2 Extension despite lack of consent

(25) In a number of circumstances, courts and arbitral tribunals will compel a party to arbitrate despite the fact that such party did not consent to the arbitration agreement, neither expressly, in writing or orally, nor tacitly. Legal reasoning used by courts and arbitral tribunals to compel arbitration in these cases have different name (fraud, abuse of right, piercing of the corporate veil, good faith, estoppel, etc.). However, they have in common that the third party's objection based on lack of consent, to a greater or lesser intensity, appears to infringe a basic sentiment of justice.

(26) It is noteworthy that, under Swiss law, the mere fact that the corporate veil is pierced does not mean *per se* that a company will be bound by an arbitration agreement entered into by its shareholders. It is only where the very independence of the company as a self-standing corporate body is denied that the arbitration agreement will be extended to it.

7. The issue of form

(27) As pointed out above, the scope of an arbitration agreement is an issue of substance which must be resolved under either of the laws designated by Article 178(2) of the Swiss Private International Law Act.

(28) What about the requirement in Article 178(1) that the arbitration agreement be in writing? In a remarkable decision of 2003, the Swiss Federal Tribunal has held that the written requirement only applies to the arbitration agreement itself, i.e. the agreement whereby the *original* parties consented to arbitration, not to its extension to a third party.

(29) This decision has given rise to a debate, the stakes of which largely exceed the limits of the extension issue. There is nothing surprising in that since, by questioning the writing requirement, it touches upon the very foundations of arbitration and the dogma that the arbitration agreement must be in writing. This decision has been criticized by those who are of the opinion that the writing requirement in Article 178(1) of the Swiss Private International Law Act is a requirement of form, whereby the consent of all parties to arbitrate must be in writing. Those who share this view

argue that the law contains sufficient mechanisms to palliate an absence of written consent when this appears necessary, for instance in cases where the reliance on such absence would be an abuse of right. On the other hand, this decision has been approved by those who promote a liberal approach towards arbitration and consider that the writing requirement merely serves to evidence the existence and contents of the arbitration agreement (Blessing, Karrer).

(30) In our opinion, the only true criticism that may be addressed to this decision is that it is a half-measure. The Federal Tribunal was (and is) probably prepared to accept or at least consider that parties may conclude an arbitration agreement without any requirement as to form. However, it may not disregard the writing requirement in Article 178(1) of the PILA. It thus found a compromise consisting in the holding that the writing requirement only applies as between the original parties, not between them and the third party to which the arbitration agreement is to be extended. This solution is unsatisfactory since it creates, without any justification, a more favorable environment to extend an arbitration agreement to a third party than to uphold the same agreement as between the original parties.

(31) On the other hand, under the law as it ought to be, the Federal Tribunal's wish to distance itself from the requirement as to form of Article 178(1) of the PILA should be approved. The arbitration agreement is basically a contract and most contracts simply result from an exchange of expression of intention, without any requirement of form. Also, parties in international arbitration are often very experienced and sophisticated commercial players who do not deserve special protection. One may add that writing may not fit with practice in specific fields of trade. In our view, it is also quite artificial to consider that the conclusion of an arbitration agreement may result from the parties' conduct, but that the implied consent should result from documents.

(32) The practical effects of this decision, however, should not be overestimated. First, although this is obvious, it only applies to the comparatively rare situation in which the issue of the extension of the arbitration agreement to a third party arises. Second, given that Swiss law will not recognize an extension as a result of the mere participation of a third party in the negotiation or conclusion of a contract, extension will actually only occur when the law governing the substance of the arbitration agreement designated by Article 178(2) of the PILA is actually more liberal than Swiss law, which will seldom be the case, or in situations where the lack of consent may be disregarded.

8. Enforcement of awards rendered against a third party

(33) Pursuant to Article V(1)(a) of the New York Convention, recognition and enforcement may be refused if it is proven that the arbitration agreement "*is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made*".

(34) In light of the above, one is tempted to conclude that, except in exceptional cases (such as, e.g., arbitrators sitting in Switzerland applying Swiss law *in favorem validatis* to extend an arbitration agreement to a third party, despite the fact that the parties had chosen a law to govern the arbitration agreement and that such law would have prohibited the extension), a third party will not be permitted to rely on the absence of a written consent to oppose the enforcement of a foreign award. It should be noted, however, that a court at the place of enforcement could consider that the arbitration agreement must comply with the writing requirement in Article II(2) of the New York Convention, and, on that basis, refuse to recognize or enforce the award as against the third party. Such a situation will arise each time the law of the State of the place of arbitration governing the validity of the arbitration agreement is more liberal than the New York Convention. The requirement in Article IV(1)(b) of the New York Convention that a certified copy of the arbitration agreement be produced is also problematic.

9. Practical considerations?

9.1 For the arbitrators

(35) Upon the challenge of an arbitral award handed down in Switzerland, the Swiss Federal Tribunal's power of review is restricted to the application of the law. It is therefore sufficient that the arbitrators find that, as a matter of fact, the third party consented to the arbitration agreement to prevent the annulment of their award on that point (unless the arbitral tribunal violated procedural fairness or public order in establishing the facts of the case). To the extent possible, the arbitrators should therefore try to establish the third party's real intent.

(36) As pointed out above, there is a risk that an award rendered in a State that has a liberal approach towards extension of arbitration agreements to third parties may not be enforced abroad. Should the arbitrators take specific actions under their duty to make an enforceable award? The answer should be in the negative. The arbitrators should follow the rules in force at the place of arbitration and, if such rules permit extension, then the arbitrators should apply them fully. In fact, arbitrators sitting in Switzerland and applying to the issue of the validity of the arbitration agreement a

foreign law more restrictive than Swiss law run the risk of seeing their award being quashed by the federal Tribunal.

9.2 For the parties (or their counsel)

(37) When it comes to extension of an arbitration agreement to a third party, the choice of the seat of the arbitration, to the extent it determines the validity of the arbitration agreement (France) or the law applicable to that question (Switzerland), as well as the choice of substantive law to govern the dispute and/or the arbitration agreement may have far-reaching consequences. These choices should be made carefully.