Can parties be bound to arbitration before signing a contract?

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In *decision 4A_84/2015*, the Swiss Supreme Court rendered a landmark decision addressing the doctrine of separability and the question of whether parties can be bound by an arbitration clause even before they have signed the contract containing the clause.

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Speedread

In a French-language decision dated 18 February 2016, published on 2 March 2016, and slated for publication in the official court reporter, the Swiss Supreme Court affirmed an arbitral tribunal's jurisdiction arising from an arbitration clause in a draft contract. While no final contract had been signed, the arbitrator found that the parties had come to a final agreement regarding the arbitration clause during their negotiations of the main contract. The Supreme Court held that in the present circumstances, this was a proper application of the separability doctrine. In doing so, the court confirmed that the requirements as to form under Swiss arbitration law constitute a mandatory minimum from which the parties cannot derogate, but supported the view that the parties can agree to elevate these requirements. (*Decision 4A_84/2015*.)

Background

The following Articles of the Swiss Private International Law Act (PILA) are relevant:

- Article 178(1) governs the formal validity of arbitration agreements. It provides that an arbitration agreement must be made in writing.
- Article 178(2) governs the substantive validity of arbitration agreements. It provides that an arbitration agreement is valid if it conforms either to the law chosen by the parties, to the *lex causae*, or to Swiss law.
- Article 178(3) enshrines the "separability doctrine", providing that an arbitration agreement cannot be challenged on the grounds that the main contract is not valid.
- Article 190(2)(b) permits a challenge against arbitral awards by international arbitral tribunals seated in Switzerland on the basis of a wrong decision on jurisdiction.

Facts

In 2012, an Iranian steel producer, Seven Diamonds Industries Co. (X), began negotiations with Z, a Cyprus-based metals trader and distributor, for a contract for the sale of steel products by Z to X. This was the first time these two companies had engaged in any commercial dealings with each other.

In March 2012, Z sent X three *pro forma* invoices for the sale of 15,000 metric tons of steel valued at EUR7,845,000. X did not sign these invoices.

On 14 May 2012, a further *pro forma* invoice was sent for 5,000 metric tons valued at EUR2,618,000. X signed this invoice. On 16 May 2012, the parties signed a sales contract for payment by draft (Sales Contract) in connection with this transaction. On 19 July 2012, Z sent X a final invoice in connection with the 14 May 2012 *pro forma* invoice. Over the next few months, Z repeatedly demanded payment, while X explained that it was unable to pay due to Iran-related international sanctions. On 17 December 2012, the parties signed a memorandum of understanding in which they agreed to reduce the payment price to approximately EUR2 million. However, X also failed to pay this reduced amount.

On 16 May 2012, that is, the same day as the Sales Contract, a chain of correspondence began between representatives of Z and X. Z emailed X a draft "Framework Contract" inviting it to sign. In what became Article 14, the Framework Contract contained a dispute resolution clause providing for arbitration seated in Lugano under the Swiss Rules, and a choice of law clause providing for the United Nations Convention on Contracts for the International Sale of Goods (CISG). On 2 September 2012, X responded with a markup of the Framework Contract. The markup changed the dispute resolution clause to ICC arbitration seated in Paris and a comment "why?" behind the choice of law provision. Z replied with a third draft, stating that it insisted on its choice of seat and institutional rules but removed the reference to the CISG. A few days later, X sent a fourth draft of the agreement, which it called a "counter proposal". This draft contained a number of changes to Z's prior draft but not to the dispute resolution clause. Z's next response on 10 September 2012, attaching a fifth draft agreement, accepted certain of these changes but introduced others, although again not regarding the dispute resolution clause. X answered by email stating that this latest draft was subject to the review of X's legal department.

However, no further correspondence was exchanged. The Framework Contract was never signed, no goods were delivered, and no payment was made.

A dispute arose, and on 9 August 2013, Z commenced a Swiss Rules arbitration against X, invoking Article 14 of the (unsigned) Framework Contract. Z claimed approximately EUR2.2 million plus lost profits. X replied, claiming lack of jurisdiction. A sole arbitrator was appointed, who decided to bifurcate the arbitration, and on 2 January 2015, rendered an award upholding his jurisdiction.

The arbitrator relied primarily on Article 178(3) PILA. The arbitrator found that the parties had agreed to arbitration even if they had not (yet) agreed on the Framework Contract (although the arbitrator left this question open). X had also argued that the individuals involved in the May-September 2012 correspondence lacked the necessary authority to bind it. However, the arbitrator found that in any event the vice president of the Iranian company had ratified the acts of its representatives.

On 2 February 2015, X brought a petition before the Swiss Supreme Court to set aside the jurisdictional award on the basis of Article 190(2)(b) PILA. X argued that the:

- Arbitration agreement was not valid because it had not been signed and the parties had agreed to require the agreement to be in writing according to Article 16 of the Swiss Code of Obligations.
- Individuals acting for X had not been properly authorised.
- Parties had not consented to arbitration.
- Dispute over the Sales Contract did not fall within the scope of the arbitration clause in the Framework Contract.

Decision

The Supreme Court rejected X's petition. It first addressed the application of Article 178(3) PILA, which it said codifies the principle of separability of the arbitration agreement.

According to the Supreme Court, the doctrine of separability means that simply alleging that the main contract did not come into existence does not void the arbitration agreement, unless the lack of consent extends to the arbitration agreement. The arbitration clause "shares the fate" of the contract in which it is contained where there is an "identity of defect." For example, where a party does not have the capacity to contract, that lack of capacity will void the main contract as well as the arbitration agreement. The Supreme Court cited with approval authors who argue that where the parties do not consent to the main contract, as a rule this lack of consent will extend to the arbitration agreement contained therein. However, the Supreme Court held that in particular and exceptional situations the contrary can be the case. For example:

- Where the parties have past contracts that include one and the same arbitration clause.
- Where the parties have an objective interest in choosing arbitration, such as neutrality of forum, international language, or confidentiality.
- Where the draft contract points to an agreement on arbitration even though no final agreement has been reached on other elements of the contract.

This could be the case – as on the present facts – where the parties exchange markups of the arbitration agreement in early drafts but then leave the (apparently agreed) clause unchanged in later drafts.

The Supreme Court then confirmed that the arbitration agreement satisfied the formal and substantive validity requirements of Articles 178(1) and (2) PILA. More specifically with regard to X's four arguments, it reasoned as follows.

Requirements as to the form of an agreement

Regarding requirements as to form, any writing is sufficient, and here, it was undisputed that the draft Framework Contract was in writing within the meaning of Article 178(1) PILA. Under this provision, a signature is not required. The court confirmed that Article 178 (1) PILA is mandatory in that the parties cannot agree to a less stringent requirement as to form. However, the court left open the issue of whether the parties may provide for more stringent requirements (which is permissible under Swiss contract law). A related question, which the court also left open, was whether an agreement containing stricter requirements as to form in the main contract also extends to the arbitration clause. Even though the court left these questions open, it strongly hinted that it would support the parties' contractual liberty to impose stricter requirements as to form because of the principle of freedom of contract and because any such agreement would serve the aim of Article 178(1), namely to reduce the uncertainty in ascertaining the will of the parties to submit to arbitration.

The court was able to leave these questions open because, unlike in these court proceedings, X had not raised this argument in the arbitration and therefore the sole arbitrator had not determined this question. X apparently thought that it could rely on Article 13 of the Swiss Code of Obligations, which provides that a contract that by law must be in writing must be signed by all persons bound to it. However, although Article 178(1) PILA (which is an autonomous law) requires that an arbitration agreement be in writing, it does not require that arbitration agreements be signed as provided for in Article 13 of the Swiss Code of Obligations.

Authorisation of party representatives

The Supreme Court rejected the argument that the Iranian negotiators lacked authority because this challenge was inadmissible. While the sole arbitrator had relied on two independent principles (good faith representation and ratification) to find that X's representatives were authorized, X only challenged the first principle and so, the challenge was inadmissible.

Parties' consent to arbitration

The Supreme Court confirmed the substantive validity of the arbitration agreement. The arbitrator had found a common subjective intent to submit disputes relating to the Framework Contract to arbitration. This constituted a finding of fact, which the Swiss Supreme Court has repeatedly held it cannot review.

Scope of the arbitration clause

Finally, the Supreme Court rejected the argument that the dispute did not fall within the scope of the arbitration clause. It left open whether this argument was even admissible in the first place, given that X had apparently not raised it before the arbitrator. In any event, the Supreme Court referred to the group of contracts theory. Where there is a material connection between a group of contracts, but only one of them contains an arbitration clause, it may be presumed that the parties agreed to submit disputes arising from any of the connected contracts to arbitration under the one arbitration clause. Here, the Framework Contract and the Sales Contract were clearly directly interconnected, which was apparent from the text of the Sales Contract and from the fact that it did not contain a dispute resolution clause of its own.

In sum, the Swiss Supreme Court observed that the case was exceptional, but that the arbitrator had properly applied the separability doctrine. Addressing X's argument that this outcome would lead to judicial uncertainty, the court stated that to avoid such uncertainty, the party could have explicitly made clear in the course of the negotiations that it would not consider itself bound by the arbitration clause before signature by both parties of the contract in which it was contained.

Comment

This decision is a "leading case" scheduled for publication in the court's official reports. The decision addresses the important issue of whether parties have concluded an arbitration agreement when exchanging drafts of a contract. The answer by the Supreme Court is in general "no", but exceptionally "yes". However, the facts of the present case are not so exceptional: parties often exchange draft agreements in which they appear to reach consensus on some elements (especially on often non-contentious issues such as dispute resolution and choice of law) but not on the final deal. International parties are often in the position in which the Supreme Court believes they would objectively favour arbitration: they hail from different countries and therefore, seek a neutral forum, an international language, and confidentiality. This is the second time in recent decisions (see *decision 4A_136/2015*) that the Supreme Court has revealed its view that international arbitration has become the default dispute resolution mechanism in international commercial transactions).

The Supreme Court confirmed that Article 178(1) PILA regarding the form of arbitration agreement constitutes a mandatory provision setting out minimum requirements from which parties cannot derogate. Whether parties can agree stricter requirements is disputed in Swiss legal literature. The question was left open here because X had not raised it properly before the arbitral tribunal or the Supreme Court. X limited the argument to an incorrect interpretation of the requirements as to form under Swiss contract law and Article 178(1) PILA. However, the Supreme Court's reasoning as well as its practical guidance leaves little doubt that it favors the position of allowing an agreement of a stricter form requirement than the one provided for in Article 178(1) PILA. This is indeed the correct approach as it is consistent with party autonomy in general and there is no reason to limit parties' autonomy to choose the form of their arbitration agreements.

It follows from this decision that where parties do not want an arbitral tribunal to decide on disputes relating to, in particular, pre-contractual or related disputes, practitioners would be well-advised to heed the Supreme Court's practice guidance in the form of an explicit reservation. However, more often than not it will be in the interest of the parties to an international contract to have pre-contractual duties adjudicated by an arbitral tribunal if a dispute arises and the main contract has not been finalised.

A further interesting aspect of this case concerned the fact that the disputed arbitration agreement was part of a framework agreement and that the specific sales contract at stake preceded the negotiation of the framework agreement and had no arbitration clause. Outside sports arbitration (see *decision 4A_6/2014*) the Supreme Court so far has been rather restrictive in assuming arbitration over related contracts (see *decision 4A_136/2015*). Here, the court's general reasoning which refers to "group of contracts" ("group de contrats") appears different and more liberal. However, it seems from the specific application in this case that the court does not intend to broaden the jurisdiction of the arbitral tribunal to every contract in a "group of contracts". The court specifically considered the framework agreement the particular purpose of which was to apply to a specific sales contract.

Case

Decision 4A_84/2015 (www.practicallaw.com/D-036-9162) (Swiss Supreme Court).

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