SWITZERLAND: Guarantor can be held to arbitration by "operation of law"

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A new decision has seen the Swiss Supreme Court clarify and "supplement" its case law on the inclusion of a guarantor in an arbitration between a creditor and a principal debtor. **Phillip Landolt** (partner) of Charles Russell LLP in Geneva reports

On 19 August the Swiss Supreme Court handed down an interesting decision (4A_128/2008).

The facts revolved around a works contract subject to Swiss law between a Qatari employer and a Cypriot contractor. Payment to the Cypriot company was required to be guaranteed by an Italian company that was, effectively, the parent of the Qatari employer. The Italian company issued a "parent company guarantee letter" guaranteeing payment "as if the guarantor was the original debtor". No choice of substantive law and no choice of jurisdiction occurred in this guarantee letter.

In an ICC arbitration in Geneva, the Cypriot company sought from both the Qatari company and the Italian company payment of amounts it claimed as due. The Italian company contested jurisdiction over itself.

In a partial award, the arbitral tribunal declined jurisdiction over the Italian company. The Cypriot company challenged this jurisdictional decision.

The Supreme Court conducted a thorough review of the principles of Swiss arbitration law concerning personal jurisdiction in the context of guarantors, a matter of immense practical significance: unless the principal debtor and the guarantor can be made parties in the same proceedings, a decision against the debtor will be unenforceable against the guarantor. Furthermore, in any court action against the guarantor the court may refuse to attribute any evidential value to the arbitral award, since the guarantor was not a party to those proceedings.

Article 178(2) of the Swiss Private International Law Act concerns the substantive validity of arbitration agreements, and the Supreme Court treats personal jurisdiction (ratione personae) as falling under this article. It provides expansively that there is personal jurisdiction if the relevant requirements of the following are fulfilled:

- the law to which the parties have subjected the arbitration clause;
- the law of the contract (lex causae); or
- Swiss law.

A guarantor may be subject to an arbitration clause by virtue of the principal contract, by virtue of the guarantee, or by virtue of conduct in relation to either. Where conduct provides the supposed submission to arbitration, an issue will often arise because of the formal requirement under Swiss law that the clause be evidenced by a text in writing. But with guarantors, this will often be satisfied by the existence of the written arbitration clause in the principal contract (or even just an oral reference to the clause).

Once it is accepted that a guarantor is subject to arbitration, for reasons of economy of procedure, the Supreme Court accepts that it may indeed be sued in the same arbitration as the principal debtor - even where the arbitration clauses in the principal contract and the guarantee are formally separate.

In this case, however, the noteworthy aspect - and the point where the Supreme Court seems to have supplemented the law - lies in the court's proposition that a guarantor may become subject to an arbitration clause not by virtue of its consent (including conduct demonstrating such consent) but by operation of law.

In practice this state of affairs is likely to be rare. All the same, the very existence of the principle is a significant development.

Article 178(1) of the Swiss Code of Obligations provides that the Swiss contract type "assumption of debt" entails that ancillary obligations pass with the debt. The Supreme Court has said that the arbitration clause is such an ancillary obligation. However, this legal effect also obtains where there is a "cumulative assumption of debt", ie, where a second debtor is joined to the obligation. The Supreme Court contrasts this operation to that which occurs in the event of a guarantee proper where, without express consent, ancillary obligations do not pass (although it accepts that functionally, a cumulative assumption of debt operates as a personal guarantee).

The Supreme Court was concerned to enunciate that this passing of the arbitration clause occurs independent of actual consent, and, instead, by virtue of the classification (one might say "characterisation") of the legal obligation. Moreover, the Supreme Court went to pains to convey that this operation is also available where the

applicable law is not Swiss law but foreign law that is analogous to the Swiss law contract type at issue. In such a case, the parties seeking the passing of the arbitration clause must show the equivalence under foreign law to Swiss cumulative assumption of debt.

Commentary

In this case, the Supreme Court has very deliberately articulated that, in principle, an arbitration clause may extend to a person by operation of law, that is, without their consent to arbitrate. All the same, one can wonder whether, in fact, presumed intention underpins the supplementary effect that the court says occurs upon characterisation of a legal relation.

In practice, this new principle is unlikely to have a big impact. The rarity of cumulative assumption of debt as a form of guarantee makes this an innocuous manner by which the Supreme Court has given itself an option for the future in developing the law in this direction.

Similarly, the attempt to extend this operation of Swiss law to obligations under foreign law that are analogous to a part of Swiss contract law looks, on its face, contrived. However, here, perhaps the Supreme Court is expressing, possibly in an overwrought fashion, the pro-arbitration character of article 178(2) of the PIL Act. Foreign law taken as a whole (both as lex causae and as lex arbitrii) may not achieve this result - but a contractual effect under foreign contract law, coupled with expansive Swiss arbitration law on the personal scope of arbitration clauses, might.