THE LAWYER

Arbitration

BRIEFING: *Switzerland*

Bound before signing on the dotted line

In a case between an Iranian company and a Cypriot company, the mere exchange of contract drafts was construed as an agreement on arbitration

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In virtually every contract negotiation, parties exchange drafts. Typically, parties do not expect to be bound by any of the terms contained in the drafts until they sign the contract. However, in its decision dated 18 February 2016 (BGer 4A_84/2015) the Swiss Federal Supreme Court found that in exceptional circumstances an arbitration clause contained in an unsigned contract draft can nonetheless bind the parties.

An Iranian and a Cypriot company were negotiating a framework agreement containing an arbitration clause. The Iranian company returned a first draft with modifications and comments including a proposal that disputes be resolved before a different arbitral institution and at a different arbitral seat. The Cypriot company sent back a revised draft stating, however, that it would not accept a change of seat. The originally proposed arbitration clause remained in the draft and was subsequently neither negotiated nor modified in a further exchange between the parties.

The Cypriot company then sent its last version of the draft agreement for signature, to which the Iranian company replied that the draft was with its legal department for approval. The agreement was ultimately never signed.

The Cypriot company later initiated arbitration proceedings on the basis of the arbitration clause in its last version of the agreement. The sole arbitrator rendered an award accepting jurisdiction. The Iranian company challenged the sole arbitrator's finding that it was bound by the arbitration clause and filed a motion to set aside the award.

Owing to the narrow grounds on which arbitral awards may be set aside in Switzerland, the Swiss Federal Supreme Court conducted a restricted examination. Still, the reasoning of its decision makes it clear that, by relying on the doctrine of separability, the parties were bound by the arbitration clause regardless of the status of the main contract.

The court considered that in exceptional circumstances parties may have entered into an arbitration agreement irrespective of whether the main contract is signed; for example, where parties have exchanged numerous drafts of the main contract that included initial modifications to the arbitration clause and subsequently left the clause unchanged in one or more exchanges. This could represent the common intention of the parties to resolve disputes by means of this arbitration clause and thus bind the parties. Therefore, even if the main contract is not concluded, a party could still initiate arbitration proceedings by relying on the arbitration clause in the last version of the contract and claim damages for breach of pre-contractual duties.

In practice, this decision by the Swiss Federal Supreme Court will increase legal uncertainty:

- A party, considering that its counterparty did not negotiate in good faith, faces the tricky question whether to file its claim before the arbitral tribunal that was provided for in the draft contract or before the state court that would otherwise be competent to hear such claims.
- Similarly, the party dragged into arbitration on the basis of an arbitration clause in a draft contract, to which it believes it never bindingly agreed, will need to consider whether to object to the arbitral tribunal's jurisdiction.
- Finally, the arbitral tribunal whose jurisdiction is challenged will first have to decide the difficult question of whether or not the exchange of drafts establishes the parties' intention to agree to arbitration.

Needless to say, parties wish to be in control of the point in time in which a contract, including any dispute resolution clause, becomes binding. Therefore, to avoid unnecessary debates and disputes, lawyers negotiating contracts are well advised:

- to expressly declare when sending or receiving the first draft containing any arbitration clause that their client does not wish to be bound by the arbitration clause until the main contract is signed. Such a declaration should dispel any doubts as to whether the parties entered into an arbitration agreement prior to the signing of the main contract. In its decision, the Swiss Federal Supreme Court indeed proposed to adopt such an approach to avoid legal uncertainty;
- to separately agree on arbitration at the beginning of negotiations (for example, in a letter of intent) if the parties indeed want arbitration to apply prior to the conclusion of the main contract so that any alleged breach of a pre-contractual duty can be brought before an arbitral tribunal.

The scenario under which the parties' conduct can in good faith be construed as an agreement to arbitrate is to be distinguished from cases in which a party's offer to arbitrate is simply met by silence. In another recent decision dated 9 March 2016 (BGer 4A_618/2015; BGer 4A_634/2015), the Swiss Federal Supreme Court declared that such silence neither met the formal nor the substantive requirements for an acceptance to arbitrate.

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