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# Arbitration Clauses in Chains of Contracts

INGEBORG SCHWENZER & FLORIAN MOHS\*

## I. Introduction

Chains of contracts involving multiple intermediaries between manufacturers and ultimate buyers from different countries have long been common practice in international trade. A recent decision of the French Supreme Court (*Cour de Cassation*) provides an excellent example for the multitude of problems that can arise in connection with arbitration clauses in such chains of contracts.<sup>1</sup>

Horizon Meats New Zealand (“Horizon Meats”) produces sheep fat and sells it to its New Zealand exporter, Blue Sky Marketing Ltd. (“Blue Sky”). The products are onsold by Blue Sky to HGL, a French importer, which in turn resells it to the ultimate French buyer, Spanghero. Because the goods are contaminated by listeriosis, Spanghero sues its immediate seller HGL in a French state court. The defendant HGL petitions the court to join Blue Sky as well as Horizon Meats for its possible claim for indemnity.<sup>2</sup> Both New Zealand companies invoke the arbitration clauses contained in their general conditions of sale. The invoices that Blue Sky sent to HGL referred to the arbitration clause. The Court of Appeal of Rennes decided that HGL as well as Spanghero are bound by the arbitration clause. On appeal by HGL, the French Supreme Court upheld the Court of Appeal’s decision and referred the parties to arbitration.

This case raises several interesting questions, amongst them the state court’s proper standard of review regarding the existence of an arbitration agreement between the parties of a dispute<sup>3</sup> and the incorporation of arbitration clauses in standard business terms. In this article, we will focus on

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<sup>1</sup> Cass. Civ. 1, 9 January 2008, 07-12349, RCDIP 2008, 128 et seq.; RDAI 2008, 435 et seq.; with case note by Elie Kleiman, International Law Office, 15 May 2008.

<sup>2</sup> Note that French law of civil procedure allows such an *appel en garantie* pursuant to Art. 331 et seq. of the French Code of Civil Procedure (Code de Procédure Civile).

<sup>3</sup> The French Supreme Court applies the principle of Competence-Competence very broadly. For its application to a case of a group of contracts cf. Cass. Comm., 25 November 2008, 07-21888, D. 2008, 3091; JCP 2009 II 10023, with case note by Elie Kleiman, International Law Office, 19 February 2009.

the most prominent issue of whether an arbitration clause binds third parties (non-signatories) in a chain of contracts. This issue is part of the overall topic of multiple parties in arbitration.<sup>4</sup> Whereas other related doctrines, for example, the groups of companies-doctrine, have been elaborated in depth,<sup>5</sup> the problems surrounding multiple parties in a distribution channel have received little attention to date.

The question that arises in litigation or arbitration proceedings of whether a non-signatory is bound by the arbitration clause is closely connected to the substantive law questions of privity of contract and the extension of contractual rights to third parties. Especially in French law, these questions have a long history culminating in the doctrine of *action directe*. It is thus no great surprise that the French Supreme Court takes the lead in raising the issue of arbitration clauses in the distribution channel. In this paper we will start by introducing the French *action directe* and the French solution of an automatic transfer of arbitration clauses down the distributive chain (infra II.). We will then compare the French position with US law (infra III.) as well as the laws of the Germanic legal family (infra IV.). In each chapter, the substantive law on products liability based on contract and quasi-contractual relationships as well as negligence and strict liability in tort will be introduced first to show that the issue of an extension of arbitration clauses in the distributive chain follows the substantive law approaches. After the overview, a comparative analysis of the solutions offered will discuss issues regarding the applicable law and the actual issue

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<sup>4</sup> Literature on the subject is abundant and a full bibliography cannot be reproduced here. Comprehensively Bernard Hanotiau, *Complex Arbitrations, Multiparty, Multicontract, Multi-issue and Class Actions*, Kluwer Law International: The Hague (2005). See further Marc Blessing, *Extension of the Arbitration Clause to Non-Signatories*, ASA Special Series No. 8 (1994), 151 et seq.; Bernard Hanotiau, *Non-Signatories in International Arbitration: Lessons From Thirty Years of Case Law*, ICCA Congress Series 2006, pages 341 et seq.; Jean-François Poudret, *Arbitrage multipartite et Droit suisse*, ASA Bull. 1991, 8 et seq.; Otto Sandrock, *Arbitration Agreements and Groups of Companies*, in: Dominicé/Patry/Reymond (eds.), *Études de droit international en l'honneur de Pierre Lalive*, Basel/Frankfurt a.M.: Helbing & Lichtenhahn (1993), 631 et seq.; Otto Sandrock, *The Group of Companies Doctrine Forms no Part of English Law – Ein bemerkenswertes Urteil der Queen's Bench*, IDR 2005, 51 et seq.; Nathalie Voser, *Multi-party Disputes and Joinder of Third Parties*, ICCA Congress Series 2008 (to be published); Tobias Zuberbühler, *Non-Signatories and the Consensus to Arbitrate*, ASA Bull. 2008, 18 et seq.

<sup>5</sup> Jan-Michael Ahrens, *Die subjektive Reichweite internationaler Schiedsvereinbarungen in der Unternehmensgruppe*, Frankfurt am Main: Peter Lang (2001); Yves Derains, *L'Extension de la clause d'Arbitrage aux non signatories – La doctrine des groupes de sociétés*, ASA Special Series No. 8 (1994), 241 et seq.; Philipp Habegger, *Arbitration and Groups of Companies – the Swiss Practice*, *European Business Organisation Law Review* 3 (2002), 517 et seq.; Charles Jarrosson, *Conventions d'arbitrage et groupes de sociétés*, ASA Special Series No. 8 (1994), 209 et seq.; Sigvard Jarvin, *The Group of Companies Doctrine*, ASA Special Series No. 8 (1994), 181 et seq.

of whether and, if so, in what cases, an extension of arbitration clauses to non-signatories in the distributive chain is warranted (*infra V.*).

## II. Chains of contracts in French law

### 1. Action directe

As long ago as 1820 the French courts recognized the possibility of a contractual claim for damages for breach of warranty (*garantie de vices cachés*) of the sub-buyer not only against its immediate seller but also directly against the manufacturer of the goods, the original seller, and every intermediary in the chain of contracts.<sup>6</sup> All sellers in the chain are jointly and severally liable to the ultimate buyer. The final distribution of liability is determined by way of recourse by the defendant seller(s) against the preceding members of the chain. The only prerequisite of the *action directe* is that the non-conformity existed at the time of each sale. Today, the ultimate buyer has a contractual damages claim against the first seller not only for breach of warranty (*garantie de vices cachés*) but also under the rules of ordinary contractual liability (*responsabilité contractuelle de droit commun*)<sup>7</sup>. In addition, the ultimate buyer may avoid the contract.<sup>8</sup>

The dogmatic justification of the *action directe* is highly controversial in French literature.<sup>9</sup> It suffices here to restate the arguments of the French Supreme Court. Since 1884, the French Supreme Court has

<sup>6</sup> Cass. civ., 25 January 1820, Recueil Général des Lois et des Arrêts, 1re partie, pages 171 et seq.; see further Civ. 3, 7 March 1990, Bull. Civ. III, No. 72: “Le sous-acquéreur est recevable à exercer l’action en garantie des vices cachés contre le vendeur originaire de la chose atteinte de vices”.

<sup>7</sup> The French Supreme Court distinguishes cases in which objective defects prevent the ordinary use of the goods (*vice caché*) from cases of subjective defects in which the goods do not conform to the contractual terms (*non-conformité*) (Cass. Civ. 1, 5 May 1993, D. 1993, jur., 506 et seq., with note by Alain Bénabent; Cass. Com., 14 October 2008, D. Notes 2009, 412 et seq.). Claims for *vice caché* become time-barred after two years from the time the buyer discovered the defect. Claims for *non-conformité* only become time-barred after 5 years (see Art. 2224 Civil Code; Art. L. 110-4 Commercial Code). The causes of action for consumers under the consumer sales law provisions in the French Consumer Code become time-barred after two years from delivery.

<sup>8</sup> Cass. com., 17 May 1982, Bull. civ. IV No. 182, with note by Larroumet, D. 1983 IR 479 et seq. The consequence of contract avoidance is mutual restitution of the goods against the purchase price, i.e. the price paid by the first buyer to the first seller, see Cass. civ. 1, 27 January 1993, JCP 1993 I 3684, noted by Jacques Ghestin: The difference between the purchase price paid by the first buyer and the purchase price paid by the ultimate buyer (claimant) may be recovered as damages.

<sup>9</sup> See Jochen Bauerreis, *Das französische Rechtsinstitut der action directe und seine Bedeutung in internationalen Vertragsketten*, Duncker & Humblot: Berlin (2001), pages 61 et seq.

justified the *action directe* by relying on the so-called theory of accessories.<sup>10</sup> According to this doctrine, warranty claims against the seller are automatically transferred to any downstream buyer as an accessory to the goods sold.<sup>11</sup>

The *action directe* is seemingly meant to benefit the ultimate buyer by granting it direct claims against any upstream member of the distribution chain. However, this benefit may be thwarted by another typical French doctrine – the theory of *non-cumul*. If a claimant can rely on contractual remedies, any concurrent action in tort is excluded,<sup>12</sup> even if the tort claim was more favorable to the buyer than its contractual claim, for example, because of the applicable statute of limitations. In 1979, the French Supreme Court held that the *non cumul*-rule applies to the ultimate buyer's *action directe* against the first seller in a chain of contracts.<sup>13</sup> We note one prominent exception to the *non cumul*-rule: statutory claims based on liability for defective products according to Articles 1386-1 et seq. French Civil Code<sup>14</sup> are admissible notwithstanding any contract between the manufacturer and the injured person. This liability however only applies in cases of personal injury or property damage sustained by the ultimate consumer.<sup>15</sup>

## 2. Automatic transfer of arbitration clauses

Given the specific feature of the *action directe* in French law, in recent years the question arose whether upstream members of the chain of contracts being sued by the ultimate buyer via *action directe* on a contractual basis can invoke an arbitration clause contained in their contract with their next tier purchaser. Because the ultimate buyer's *action directe* is derived from the initial contract between the first seller (often

<sup>10</sup> Cass. civ., 12 November 1884, S. 1886 I 149; Ghestin/Jamin/Billiau, *Traité de droit civil – Les effets du contrat*, 3ed. Paris (2001), No.1116, page 1198.

<sup>11</sup> To understand the doctrine, one should be reminded that, according to French law, the title to specified goods passes to the buyer at the time of the conclusion of the contracts.

<sup>12</sup> Philippe Malaurie/Laurent Aynès, *Obligations*, vol 2, 11ed 2001/2002, paras. 610 et seq.; Peter Schlechtriem, *Vertragsordnung und außervertragliche Haftung*, Alfred Metzner Verlag: Frankfurt am Main (1972), pages 63 et seq.

<sup>13</sup> Cass. civ. 1, 9 October 1979, Bull. civ. I No. 241, with note by André Plancqueel, *Gaz. Pal.* 1980 Jur. 249 et seq.; with note by Georges Durry, *RTD civ.* 1980, 354 et seq.

<sup>14</sup> Articles 1386-1 et seq. incorporate Council Directive 85/374/EEC of 25 July 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products. See *Loi n° 98-389 du 19 mai 1998 relative à la responsabilité du fait des produits défectueux*.

<sup>15</sup> Article 1386-2 CC.

the manufacturer) and the first buyer, the defendant first seller can invoke all defenses under the initial contract against the third party claimant (ultimate buyer).<sup>16</sup> For a long time, an exception to this rule was made for arbitration clauses. Arbitration clauses could not be invoked against the third party claimant because, according to the doctrine of severability, the arbitration agreement is understood as a contract distinct from the sales contract which requires separate consent by both parties to the dispute.<sup>17</sup> But things have changed recently:

In *Peavy*,<sup>18</sup> a French buyer, Claey's Luck, sued the US first seller, Peavy, because the Syrian sub-buyer, OGF, had refused to take delivery of corn that was affected by snout beetle. Claey's Luck's action against Peavy was finally dismissed and referred to arbitration. By applying the arbitration clause, which was included in the standard business terms referred to in the initial sales contract, to Claey's Luck as a third party, the French Supreme Court emphasized the necessity of a uniform outcome of the proceedings for all parties involved.<sup>19</sup> However, the French Supreme Court's holding contained one caveat: The arbitration clause is not automatically transferred if the third party proves that it was reasonable to ignore the existence of an arbitration clause in the first contract.<sup>20</sup>

The restriction of reasonable ignorance was discarded by the French Supreme Court in the famous ABS case.<sup>21</sup> The French company ABS had a contract with the Belgian company AME for the manufacture of microchips. AME in turn bought electronic components from the US-American company Amkor, which purchased them from the Korean company Anam. Both the contract between AME and Amkor as well as the contract between Amkor and Anam contained arbitration clauses designating the AAA as the competent arbitration institution but different seats of the arbitral tribunal to be established. Relying on the non-conformity of the goods, ABS sued Amkor as well as Anam in French state courts. The Paris Court of Appeal did not allow the defendants to invoke the arbitration clause because it found that ABS'

<sup>16</sup> See Jochen Bauerreis, *Das französische Rechtsinstitut der action directe und seine Bedeutung in internationalen Vertragsketten*, 2001, pages 61 et seq.

<sup>17</sup> Cass. civ. 1, 6 November 1990, Bull. civ. I No. 230; Philippe Delebecque, *La transmission de la clause compromissoire*, Rev. arb. 1991, 19 et seq.

<sup>18</sup> Cass. civ. 1, 6 February 2001, Bull. civ. I No. 22, with note by Daniel Cohen, Rev. arb. 2001, 765 et seq.

<sup>19</sup> The Court held (at Rev. arb. 2001, 765, 767): "[...] le litige présente [...] un caractère d'indivisibilité."

<sup>20</sup> The Court held (at Rev. arb. 2001, 765, 766): "[...] sauf preuve de l'ignorance raisonnable de l'existence de cette clause."

<sup>21</sup> Cass. civ. 1, 27 March 2007, Rev. arb. 2007, 785 et seq., with a note by Jalal El Ahdab; D. 2007, 2077 et seq., with a note by Sylvain Bollée.

claim was based on tort. However, the French Supreme Court did not follow the Court of Appeal's reasoning but confirmed that the arbitration clause extended to ABS because

*« dans une chaîne de contrats translatifs de propriété, la clause compromissoire est transmise de façon automatique en tant qu'accessoire du droit d'action, lui-même accessoire du droit substantiel transmis, sans incidence du caractère homogène ou hétérogène de cette chaîne. »*

In conclusion, the French Supreme Court undertakes a two-step analysis: First, the substantive claim against the first and any downstream seller is automatically transferred to the ultimate buyer as an accessory to the goods sold. Secondly, as an accessory to the substantive claim, the arbitration clause passes automatically to the ultimate buyer.

This analysis of the French Supreme Court has been reaffirmed in the HGL case, which was described in the introduction to this article. It may now be regarded as settled French law.

### III. Chains of contracts in US law

#### 1. The first seller's warranty liability towards the ultimate buyer

Originally, the common law was firmly based on the principle of privity of contract. Unlike the French solution using the contractual recourse via *action directe*, in the US, the problem of products liability has been solved primarily by imposing a strict liability sounding in tort upon the manufacturer of any defective product.<sup>22</sup> However, certain cases remain where a remote buyer may rely upon contractual liability for breach of warranty against a seller within the distributive chain that is not its direct contractual partner; such remote buyers are referred to as vertical non-privity plaintiffs.<sup>23</sup> In practice, often both strict liability and warranty are pleaded to insure full recovery, specifically for economic loss.

The Uniform Commercial Code ("UCC") provides three alternatives in § 2-318 regarding the recovery by non-privity plaintiffs. Whereas alternatives

<sup>22</sup> Restatement of the Law, Third, Torts: Products Liability, § 1; Restatement of the Law, Second, Torts, § 402; *Greenman v. Yuba Power Products, Inc.*, 377 P.2d 897 (Cal. 1969); *MacPherson v. Buick Motor Co.*, 11 N.E. 1050 (N.Y. 1916); David G. Owen and Jerry J. Phillips, Products Liability in a nutshell, 7<sup>th</sup> ed. 2005, § 5.1, p. 121.

<sup>23</sup> White/Summers, Uniform Commercial Code, 5<sup>th</sup> ed. 2000, § 11-2, p. 399.

A and B are restricted to personal injury and property damage, alternative C covers economic loss as well. Almost all states have adopted some version of § 2-318 UCC.<sup>24</sup>

In addition to these statutory possibilities, the courts in some states have based products liability on the theory of breach of an implied warranty.<sup>25</sup> This liability does not only cover personal injury and property damage but may also include economic loss, at least if the ultimate buyer is a consumer.<sup>26</sup> In the meantime, a growing number of courts now allow non-privity plaintiffs to recover for direct and even consequential economic loss.<sup>27</sup>

Furthermore, non-privity plaintiffs may rely on the first seller's express representations made in advertising or otherwise. Usually courts classify these cases as express warranty cases.<sup>28</sup>

The 2003 Amendments to Article 2 of the UCC introduced two new obligations extending from a seller to a remote purchaser regarding liability for false information and advertisement.<sup>29</sup> Under these amendments, a remote purchaser cannot claim lost profits. At present, no state has adopted these particular amendments.

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<sup>24</sup> Only Louisiana has never enacted Article 2 UCC. Texas has left questions of privity for the courts. California omitted § 2-318 UCC but has enacted a separate statute that is similar to Alternative C. See William L. Stallworth, *An Analysis of Warranty Claims Instituted by Non-Privity Plaintiffs in Jurisdictions That Have Adopted Uniform Commercial Code Section 2-318 (Alternative A)*, 20 Pepp. L.Rev. 1215, 1229 (1993). A number of states have adopted alternative C or a similar provision or have enacted their own expansive provision, see White/Summers, *Uniform Commercial Code*, 5th ed. (2000), § 11-3, page 403.

<sup>25</sup> *Henningsen v. Bloomfield Motors, Inc.*, 32 N.J. 358, 161 A.2d 69, 75 A.L.R.2d 1 (N.J. 1960).

<sup>26</sup> Pro: *Santor v. A. & M. Karagheusian, Inc.*, 44 N.J. 52, 207 A.2d 305, 16 A.L.R.3d 670 (N.J. 1965). Limiting: *Spring Motors Distributors v. Ford Motor Co.*, 98 N.J. 555, 489 A.2d 660 (N.J. 1985), holding that commercial buyer seeking damages for economic loss should only proceed under the UCC against parties in the chain of distribution. Contra: *Seely v. White Motor Co.*, 63 Cal.2d 1, 403 P.2d 145, 45 Cal.Rptr. 17 (Cal. 1965), holding that consumer could not recover in strict liability for economic loss. Cf. White/Summers, *Uniform Commercial Code*, 5th ed. 2000, § 11-2, § 11-5.

<sup>27</sup> *Gonzalez v. PepsiCo, Inc.*, 489 F.Supp.2d 1233, 62 UCC Rep.Serv.2d 841 (D. Kan. 2007); *Israel Phoenix Assur. Co. v. SMS Sutton, Inc.*, 787 F.Supp. 102, 18 UCC Rep.Serv.2d 120 (W.D.Pa. 1992); *Sullivan Indus., Inc. v. Double Seal Glass Co., Inc.*, 192 Mich.App. 333, 480 N.W.2d 623, 17 UCC Rep.Serv.2d 61 (Mich. App. 1991), followed by *Pack v. Damon Corp.*, 2006 FED App. 0042P (6th Cir. 2006); White/Summers, *Uniform Commercial Code*, 5th ed. 2000, § 11-5, page 406.

<sup>28</sup> White/Summers, *Uniform Commercial Code*, 5th ed. 2000, § 11-7.

<sup>29</sup> § 2-313A and § 2-313B; see generally Henry D. Gabriel and William H. Henning, *2003 Amendments to Uniform Commercial Code Articles 2-Sales*, LexisNexis/Matthew Bender, Newark/San Francisco, 2003; Nazmi Orkun Akseli, *Advertising and "Pass-Through" Warranties Under Revised Article 2*, 106 Com. L.J. 65 et seq. (2001).

## 2. Transfer of arbitration clauses under the doctrine of (equitable) estoppel

The US Supreme Court has held as a starting point that, due to its contractual nature, an arbitration agreement may only be extended to non-signatories in rare circumstances.<sup>30</sup> Such circumstances are present if so dictated by the ordinary principles of contract and agency.<sup>31</sup> Case law has developed certain groups of cases in which the arbitration clause extends to a non-signatory.<sup>32</sup> Amongst them are the doctrines of agency, veil piercing/alter ego, and (equitable) estoppel.<sup>33</sup> The chain of contracts cases are primarily dealt with under the topic of (equitable) estoppel. However, in a given case, other doctrines might apply as well, especially where certain members of the distribution chain belong to the same group of companies.

Equitable estoppel may arise in two forms. In the first form, equitable estoppel is used as a broad notion of intertwined issues.<sup>34</sup> Specifically, courts refuse a signatory being sued by a non-signatory to escape from arbitration if the non-signatory's claim is inextricably intertwined with the signatory's contractual obligations.<sup>35</sup> Even a signatory suing a non-signatory and thereby

<sup>30</sup> *United Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582 (1960): "For arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." *AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 648 et seq. (1986); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 115 S.Ct. 1920, 131 L.Ed.2d 985 (1995); *Equal Employment Opportunity Commission v. Waffle House, Inc.*, 534 U.S. 279, 289, 122 S.Ct. 754, 762, 151 L.Ed.2d 755, 766 (2002). *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625, 105 S.Ct. 3346, 87 L.Ed.2d 444 (1985).

<sup>31</sup> *McAllister Bros., Inc. v. A & S Transp. Co.*, 621 F.2d 519, 524 (2nd Cir. 1980).

<sup>32</sup> *Thomson-CSF, S.A. v. American Arbitration Association, Evans & Sutherland Computer Corporation*, 64 F.3d 773, 776 (2nd Cir. 1990); James M. Hosking, Non-Signatories and International Arbitration in the United States: the Quest for Consent, 20(3) *Arb. Int.* 289, 291 (2004); see Florian Mohs, *Drittwirkung von Schieds- und Gerichtsstandsvereinbarungen*, Sellier. European Law Publishers: Munich (2006), page 42 et seq.

<sup>33</sup> Gary B. Born, *International Commercial Arbitration*, Kluwer Law International: The Netherlands (2009), pages 1142 et seq; Margaret L. Moses, *The Principles and Practice of International Commercial Arbitration*, Cambridge University Press: Cambridge/New York (2008), pages 33 et seq.

<sup>34</sup> Hanotiau, *ibid*, pages 20 et seq.

<sup>35</sup> *MS Dealer Service Corp. v. Sharon D. Franklin*, 177 F.3d 942, 947 et seq. (11th Cir. 1999); *Turtle Ridge Media Group, Inc. v. Pacific Bell Directory*, 140 Cal. App. 4th 828 (Cal. App. 2006); Jennifer Kirby, *Sourcing Unlimited, Inc. v. Asimco Int'l, Inc.*: Appellate Jurisdiction and Equitable Estoppel, 26(1) *Journal of International Arbitration* (2009), 149, 153, 155. But see *Ervin v. Nokia, Inc.*, 349 Ill.App.3d 508, 812 N.E.2d 534, 285 Ill.Dec.714 (Ill. App. 2004): the Court denied cellular phone manufacturer's motion to compel consumer to arbitration based on an arbitration provision in phone service contract between the consumer and the phone service provider to which the manufacturer was not a party. Specifically, the Court declined to follow the broad notion of estoppel under *MS Dealer*, *ibid*, at 349 Ill.App.3d 508, 516. Already pointing at the same direction *International Paper Company v. Schwabedissen Maschinen & Anlagen GmbH Int'l Paper*, 206 F.3d 411, 418 n.6 (4th Cir. 2000) (obiter): The Second Circuit has held, however, that a "close relationship" and "intimate" factual

relying on the terms of the contract containing the arbitration clause was held bound to arbitrate.<sup>36</sup> Common to both situations is that the signatory is bound to arbitrate with a non-signatory at the non-signatory's insistence. In the opposite constellation where a signatory seeks to compel a non-signatory to arbitration the courts have rejected the application of estoppel in its first form.<sup>37</sup>

In the second form, equitable estoppel is applied to the opposite constellation in which the non-signatory ultimate buyer brings its action in a state court and the signatory seller invokes the arbitration clause contained in its contract with the first buyer.<sup>38</sup> If the ultimate buyer has received direct benefits from the contract between the signatories, it will then be subjected to the arbitration clause.<sup>39</sup> The leading US case in this regard is *International Paper Company v. Schwabedissen Maschinen & Anlagen GmbH* where a buyer of an industrial saw sued the manufacturer in state courts, asserting

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connection provide no independent basis to require a nonsignatory of an arbitration agreement to arbitrate with a signatory, and therefore that a nonsignatory cannot be bound without receiving a "direct benefit" from or pursuing a "claim [...] integrally related to the contract containing the arbitration clause".

<sup>36</sup> *MS Dealer Service Corp. v. Sharon D. Franklin*, 177 F.3d 942, 43 Fed.R.Serv.3d 1204 (11th Cir. 1999): car buyer equitably estopped from avoiding arbitration of her claims against service corporation pursuant to arbitration clause in contract between car buyer and dealer. *Grigson v. Creative Artists Agency, LLC*, 210 F.3d 524 (5th Cir. 2000): applying equitable estoppel to require plaintiff to arbitrate claim of tortious interference with contract against non-signatory to contract containing arbitration clause. *Goer v. Jasco Industries, Inc.*, 395 F.Supp.2d 308 (D.S.C. 2005): subsidiary's employees bound to arbitrate their claims against parent company and its principal under employment agreements containing broad arbitration clause entered into with subsidiary. *Sunkist Soft Drinks, Inc. v. Sunkist Growers, Inc.*, 10 F.3d 753 (11th Cir. 1993).

<sup>37</sup> *Thomson-CSF, S.A. v. American Arbitration Association, Evans & Sutherland Computer Corporation*, 64 F.3d 773, 779 (2nd Cir. 1990); *InterGen N.V. v. Grina*, 344 F.3d 134, 145 et seq. (1st Cir. 2003).

<sup>38</sup> Hanotiau, *ibid.*, page 24, paras 49.

<sup>39</sup> See *Southern Illinois Beverage, Inc. v. Hansen Beverage Company*, 2007 WL 3046273 (S.D.Ill. 2007): in its direct action against the manufacturer, the subdistributor was required to arbitrate because it relied on the contract between the manufacturer and the first distributor which contained an arbitration clause; *American Bureau of Shipping v. Tencara Shipyard S.P.A.*, 170 F.3d 349 (2nd Cir. 1999); *Jackson III, p/k/a 50 Cent v. Iris.com*, 524 F.Supp.2d 742 (E.D.Va. 2007); *Hughes Masonry Company, Inc. v. Greater Clark County Sch. Bldg. Corp.*, 659 F.2d 836 (7th Cir. 1981): masonry contractor had a contract with principal containing an arbitration clause and was bound to arbitrate against a construction manager hired by principal under a separate contract because it relied on its contract to set out its claim against the third party. Note, however, that all contracts contained similar arbitration clauses and were intertwined with each other. But see *In re Kellogg Brown & Root, Inc.*, 166 S.W.3d 732, 48 Tex. Sup. Ct. J. 678 (Tex. 2005): second-tier subcontractor not required to arbitrate its non-contractual direct claim (quantum meruit) against contractor despite the fact that an ICC arbitration clause existed in the first-tier subcontract. *Griffin & Company v. Beach Club II Homeowners Association, Inc.*, 384 F.3d 157 (4th Cir. 2004): plaintiff's claim that contractor breached implied warranty of good workmanship arose from its role as builder, and these legal duties were not dependent on terms of the contract with developer that contained arbitration clause; *InterGen N.V. v. Grina*, 344 F.3d 134, 145 et seq. (1st Cir. 2003): contract containing arbitration clause was under an integration clause explicitly restricted to seller and buyer so that no third-party rights were afforded to buyer's parent company.

claims for breach of contract, rejection, and breach of warranties.<sup>40</sup> The Court held that the doctrine of equitable estoppel applied to preclude the buyer from asserting that, as non-signatory, it was not bound by the arbitration clause in the contract between the manufacturer and the distributor. The same result was reached in the US-American half of the ABS dispute where parallel litigation tracks were set in Paris and in the US District Court, Eastern District of Pennsylvania. In the US law suit, Amkor, among others, sought an order compelling ABS and others to submit to arbitration.<sup>41</sup> Although the Court based its decision primarily on the fact that ABS and AME were at all relevant times sister companies and played a fairly significant role in carrying out the contract, it held in the alternative that ABS had received a direct benefit from the contract and was thus bound by the arbitration clause.<sup>42</sup>

#### IV. Germanic legal systems

##### 1. Direct claims of the ultimate buyer against the manufacturer

Germanic legal systems are much more reluctant to grant ultimate buyers in a chain of contracts a contractual remedy against the first seller or other non-privity upstream members. Especially the *action directe* is not known for liability in chains of contracts.

In Germany, the Federal Supreme Court (*Bundesgerichtshof*) in its leading decision on products liability<sup>43</sup> expressly denied any contractual construction but instead relied on tort law. The same holds true for Switzerland where the Federal Supreme Court (*Bundesgericht*) relied upon the tortious liability for auxiliary persons.<sup>44</sup> It is only the Austrian Supreme Court (*Oberster Gerichtshof*) that resorts to a contractual foundation of products liability relying on a so-called contract with protective effects on

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<sup>40</sup> 206 F.3d 411 (4th Cir. 2000).

<sup>41</sup> *Amkor Technology, Inc. v. Alcatel Business Systems*, 278 F.Supp.2d 519 (E.D. Pa. 2003).

<sup>42</sup> Likewise ABS was not heard in alleging that its claims were based in tort because the arbitration clause expressly covered “any claim based on contract, tort or statute.”

<sup>43</sup> German Federal Supreme Court, 26 November 1968, BGHZ 51, 91 (so-called “fowl pest”-decision).

<sup>44</sup> Swiss Federal Supreme Court, 9 November 1984, BGE 110 II 456. The doctrine of “reliance liability” (*Vertrauenshaftung*) that has been invented as a new part of the law of obligations next to contracts and torts by the Federal Supreme Court in its decisions of 15 November 1994, BGE 120 II 331, and 10 October 1995, BGE 121 III 350, has not been applied to chains of contracts yet, see Federal Supreme Court, 12 June 2007, BGE 133 III 449, where a direct claim for payment of a subcontractor against the principal in a chain of construction contracts was denied.

third parties (*Vertrag mit Schutzwirkung zugunsten Dritter*).<sup>45</sup> However, since the implementation of the Austrian Products Liability Act,<sup>46</sup> recourse to such a contractual construction has become – although still possible – less important in practice,<sup>47</sup> mainly because recovery of economic loss is not permitted under this cause of action either.<sup>48</sup>

Direct contractual rights of the ultimate buyer against a manufacturer or a distant seller in the chain of contracts may also arise if the latter grants a special and independent guarantee, for example, warranting the product to be free from defects in material and workmanship for a specific period of time while, at the same time, limiting the buyer's right to repair and replacement.<sup>49</sup> Such an independent guarantee may also be construed as a third party beneficiary contract (*echter Vertrag zugunsten Dritter*) entered into between the manufacturer and the first buyer for the benefit of the ultimate buyer.<sup>50</sup>

Apart from independent guarantees, contractual liability is – with the exception of Austria – strictly limited to the immediate parties to each contract in the chain of contracts. In Switzerland, Germany, and Austria, when the ultimate buyer asserts contractual liability against its immediate seller, primarily to recover direct or consequential economic loss, the seller itself has in turn to resort against its immediate contractual partner to recover its liability loss. Eventually, after several separate actions the manufacturer will be held responsible and will thus shoulder the loss. Collectively these successive actions are described as rolling up the distributive chain.

On the procedural level, the substantive law system is closely mirrored by the principle of a two party civil process. The starting point is to have two parties to a contract and accordingly two parties to civil proceedings. Only a third party notice (*Streitverkündung*, comparable to 'vouching' under US

<sup>45</sup> Austrian Supreme Court, 4 February 1976, SZ 49/14; Rudolf Welser/Christian Rabl, *Produkthaftungsgesetz*, Kommentar, Lexis Nexis ARD Orac: Vienna (2nd ed. 2004), Introduction (Vorbemerkungen), para. 7.

<sup>46</sup> The Act incorporated the Council Directive 85/374/EEC of 25 July 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products.

<sup>47</sup> Austrian Supreme Court, 20 January 1991, SZ 64/82; Rudolf Welser/Christian Rabl, *ibid*, Introduction (Vorbemerkungen), para. 8.

<sup>48</sup> Austrian Supreme Court, 28 November 1978, SZ 51/169; Rudolf Welser/Christian Rabl, *ibid*, Introduction (Vorbemerkungen), para. 7.

<sup>49</sup> Cf. Swiss Federal Supreme Court, 8 February 2008, BGE 134 III 218, holding that a manufacturer's guarantee to a sub-purchaser does not constitute a service contract under Article 13 Lugano Convention but considering such a guarantee as a unilateral contract *sui generis*.

<sup>50</sup> German Federal Supreme Court, 28 June 1979, BGHZ 75, 75; see H. P. Westermann, *Münchener Kommentar zum BGB*, Beck: Munich (5th ed. 2008), § 443 BGB para. 7.

law<sup>51</sup>) may help to gain procedural advantages in the recourse proceedings against the next upstream member of the chain. In any event, the final seller needs to institute another law suit against its supplier. In this second process, the third party notice has the effect that the negative outcome of the first process affects the defendant supplier if the latter cannot show that, in the first process, the plaintiff seller has improperly defended itself and consequently lost its case.

As of today, only three cantons of Switzerland, Geneva, Vaud, and Wallis allow, with French inspiration, an impleader action (*appel en cause*) of the defendant seller against its upstream contractual partner.<sup>52</sup> However, the Draft Federal Code of Civil Procedure<sup>53</sup> recognizes both third party notice<sup>54</sup> and impleader actions.<sup>55</sup> With respect to chains of contracts, the Draft Federal Code of Civil Procedure allows only third party notices against the next and, subsequently, every upstream members of the chain. By contrast, the impleader action may only be used by the first defendant.<sup>56</sup>

In conclusion, only Austria acknowledges direct contractual claims of the ultimate buyer against upstream members in the distributive chain. Germany and Switzerland only grant tort claims.

## 2. Extension of arbitration clause to non-signatories

Since the scope of contractual liability between non-privity members of a chain of contracts in the Germanic legal systems is rather limited, it comes as no great surprise that the subsequent question of a possible extension of an arbitration clause to the non-signatory has not yet been dealt with in any depth.<sup>57</sup>

<sup>51</sup> Vouching: § 2-607(5) UCC. Apart from that, common law vouching remains possible in situations when the modern devices of impleader and interpleader for joining a non-party (Rule 14 of the Federal Rules of Civil Procedure) are not available, see *SCAC Transport (USA), Inc. v S.S. "Danaos"*, 578 F.Supp. 327 (S.D.N.Y. 1984).

<sup>52</sup> *Appel en cause*: Art. 104 et seq. Code of Civil Procedure of Geneva; Art. 83 et seq. Code of Civil Procedure of Vaud; Art. 53 et seq. Code of Civil Procedure of Valais. Art. 8 Federal Statute on Venue in Civil Proceedings allows cantonal law to grant jurisdiction over an impleader by the defendant as to sue and bring in a third party defendant to the court that has jurisdiction over the first process.

<sup>53</sup> Swiss Parliament has adopted a new Federal Code of Civil Procedure dated 19 December 2008, which is expected to enter into force on 1 January 2011.

<sup>54</sup> *Streitverkündung*: Art. 78 et seq. Draft Federal Code of Civil Procedure.

<sup>55</sup> *Streitverkündungsklage*: Art. 81 et seq. Draft Federal Code of Civil Procedure.

<sup>56</sup> Art. 78(2), 81(2) Draft Federal Code of Civil Procedure.

<sup>57</sup> Zuberbühler, *ibid*, pages 30-1, indicates that the US-American concept of estoppel might influence Swiss jurisprudence in applying the prohibition of abuse of rights to third party situations.

However, as far as a claim is brought as a true third party beneficiary of a contract, it is generally agreed that the beneficiary is bound by any terms of the contract upon which it is relying including an arbitration clause.<sup>58</sup> This doctrine could be applied to cases in which the ultimate buyer claims directly against the manufacturer under an independent guarantee. The reason for holding third party beneficiaries to the arbitration agreement is the same as that given by US-American courts: If a party asserts rights stemming from a third party contract, it is confined to its limits. The third party beneficiary is free to enforce the contractual rights or to reject the benefit conferred on it.<sup>59</sup> If it chooses to enforce its contractual right, then it cannot at the same time negate the very terms of the contract.

Furthermore, Austrian literature suggests that an extension of the arbitration clause is not only warranted in cases of a true third party beneficiary contract (*Vertrag zugunsten Dritter*) but also in cases of contracts with protective effects on third parties (*Vertrag mit Schutzwirkung zugunsten Dritter*).<sup>60</sup>

## V. Comparative Discussion

### 1. Summary of positions taken by the different legal systems

The legal systems studied above show significant differences regarding the extension of arbitration clauses to non-signatories in the distributive

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<sup>58</sup> For Switzerland: Patrick Krauskopf, *Der Vertrag zugunsten Dritter*, Universitätsverlag Freiburg, Schweiz: 2000, para. 1760; Thomas Rüede/Reimer Hadenfeldt, *Schweizerisches Schiedsgerichtsrecht nach Konkordat und IPRG*, Zurich: Switzerland (2nd ed. 1993), p. 81. For Germany: German Federal Supreme Court, 22 May 1967, BGHZ 48, 35, 45, NJW 1967, 2057, 2059 (obiter); Gerhard Wegen/Marcel Barth, *Praktische Tipps für den Abschluss einer Schiedsklausel*, in: Torggler (ed.), *Praxishandbuch Schiedsgerichtsbarkeit*, Verlag Österreich: Vienna (2007), page 59, 72; Hans-Joachim Musielak, *Kommentar zur Zivilprozessordnung mit Gerichtsverfassungsgesetz*, Verlag Franz Vahlen: München (6th ed. 2008), § 1029 ZPO, para. 8; Peter Schlosser, *Das Recht der internationalen privaten Schiedsgerichtsbarkeit*, J.C.B. Mohr (Paul Siebeck): Tübingen (2nd ed. 1989), para. 425. For Austria: Austrian Supreme Court, 13 June 1995, 4Ob533/95, available at <http://www.ris.bka.gv.at>; Gerold Zeiler, *Schiedsverfahren*, Neuer Wissenschaftlicher Verlag: Wien/Graz (2006), § 581 para. 112; Christian Hausmaninger in Fasching/Konecny (eds.), *Kommentar zu den Zivilprozeßgesetzen*, Manzsche Verlags- und Universitätsbuchhandlung: Vienna (2nd ed. 2007), § 581 ZPO para. 210 et seq.

<sup>59</sup> Ingeborg Schwenger, *Schweizerisches Obligationenrecht Allgemeiner Teil*, Bern: Stämpfli (4th ed. 2006), para. 86.19.

<sup>60</sup> Christian Hausmaninger in Fasching/Konecny (eds.), *Kommentar zu den Zivilprozeßgesetzen*, Manzsche Verlags- und Universitätsbuchhandlung: Vienna (2nd ed. 2007), § 581 ZPO para. 215.

chain. Whether or not an arbitration clause is extended to an ultimate buyer that has not agreed to the arbitration clause largely depends on substantive law concepts regarding legal remedies in the chain of contracts. French courts have relied on a broad notion of *action directe* for almost two hundred years, generously applying arbitration clauses to non-signatories in the distribution channel. Similarly, in Austria, products liability has been based on the theory of a contract with protective effects on the third party, which in turn is bound by the arbitration clause in the contract. On the other side of the spectrum are Switzerland and Germany where, except for independent guarantees by manufactures, neither the third party beneficiary contract nor the contract with protective effects on third parties are applied to chains of contracts. Between these two poles, an intermediate position is favored in the USA where contractual remedies by ultimate buyers are gaining ground and, in such a case, the courts are ready to extend arbitration clauses via the doctrine of equitable estoppel.

## 2. Applicable law

The first problem to raise here is that almost none of the courts discussing contractual rights of the ultimate buyer and the extension of the arbitration clause have addressed the issue of the applicable law. The authors oppose any trend of establishing a uniform but unwritten rule allegedly founded in the law of international arbitration to provide for the extension of arbitration clauses in the distributive chain. By contrast, the question of any extension of arbitration clauses is intertwined with the substantive law solutions. Therefore, in an international setting, the issue arises which law shall be applied to determine whether or not an arbitration clause extends through the distributive chain. This question has to be addressed at two stages: The first question is which law governs the ultimate buyer's substantive claim. If the law so determined gives the ultimate buyer a remedy against the manufacturer, the second step is to ask which law applies to the extension of the arbitration clause to the non-signatory third party buyer.

### a) Law applicable to the ultimate buyer's substantive claims

The French Supreme Court in its pertinent decisions does not discuss private international law at all, but seems to be inspired wholly by French domestic law. This approach is reinforced by the application of the *lex fori* to the admissibility of an *action directe*.<sup>61</sup> French courts qualify the *action*

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<sup>61</sup> See Bauerreis, *ibid*, p. 292, with further references.

*directe* in accordance with French law as contractual and then apply the law applicable to the first contract as to the content and the extent of the ultimate buyer's contractual claims against the first seller.<sup>62</sup> This approach leads in most cases to the foreign law of the first seller/manufacturer.<sup>63</sup> The outcome has been criticized in doctrine; several other theories have been invented, the most prominent of which suggests applying the law applicable to the first contract to the question of whether a direct action is permissible.<sup>64</sup>

A decision by the European Court of Justice however has illuminated that the French *action directe* cannot be qualified as a matter relating to a contract in the sense of Article 5(1) of the European Convention of 27 September 1968 on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters Convention.<sup>65</sup> This is because a contract in that sense cannot be understood as covering a situation in which there is no obligation freely assumed by one party towards another. Similarly, the Austrian Supreme Court has ruled that despite the seemingly contractual nature of products liability, the applicable law in an international context has to be determined by the conflict rules on tort law.<sup>66</sup>

In our opinion, the reasoning of the ECJ and the Austrian Supreme Court as expressed in relation to international jurisdiction applies analogously to the issue of the applicable law. Because the manufacturer has not freely assumed any obligation in the relationship towards the ultimate purchaser, the applicable set of conflicts of law rules shall qualify the relationship as a tort and apply the respective provisions on products liability or, absent such a specific provision, the general provisions on torts. The relevant conflicts rules may be derived from uniform law instruments if the forum state is a member state of the Hague Convention of 2 October 1973 on the Law Applicable to Products Liability<sup>67</sup> or a member state of the European Community (e.g. Germany and Austria) where the Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on

<sup>62</sup> Cass. civ. 1, 10 October 1995, D. 1996 Somm. 171, et seq.; note by L.-C. Henry, JCP 1996 II 22742; note by V. Heuzé, Rev. crit. DIP 1996, 332 et seq.; Cass. civ. 1, 6 February 1996, Rev. crit. DIP 1996, 460 et seq., with note by D. Bureau.

<sup>63</sup> Claude Witz, D. 1999 Jur. 383, 384. French courts apply the Convention on the law applicable to international Sales of Goods of 15 June 1955.

<sup>64</sup> See Bauerreis, *ibid*, p. 307.

<sup>65</sup> *Jakob Handte & Co. GmbH v. Traitements mécano-chimiques des surfaces SA*, ECJ, 17 June 1992, C-26/91, Rev. crit. DIP 1992, 726 et seq., with note by Hélène Gaudemet-Tallon; note by Christian Larroumet, JCP 1992 II 21297; note by J.-M. Bischoff, JDI 1993, 469 et seq.

<sup>66</sup> OGH, 29 October 1987, 7 Ob 623/87, IPRax 1988, 363 et seq.

<sup>67</sup> See <http://www.hcch.net>.

the law applicable to non-contractual obligations (Rome II)<sup>68</sup> applies. The private international law of the different US states is uncodified law; the pertinent case law does not allow a conclusion as to how the courts would qualify the relationship between ultimate buyer and manufacturer in an analysis of private international law. If the forum is Switzerland, Article 135 Federal Act on Private International Law (PILA) would apply. Although this Article contains a specific provision on products liability in relation to the general provision on torts, it shall apply to contractual claims relating to products liability as well.<sup>69</sup> By applying different possible connecting factors to the determination of the applicable law, all these provisions warrant correct adjustment of the interests of the ultimate purchaser for its protection (place of its habitual residence, place of injury, place where product was acquired) and the interests of the manufacturer for limiting its potential liability to foreseeable loss (place of business of the person claimed to be liable).<sup>70</sup>

The law applicable to products liability or torts determines the possibility of direct contractual recourse against the manufacturer as well as the content and extent of this liability. Only in the case of manufacturers' guarantees can the relationship between the manufacturer and the ultimate buyer be qualified as contractual. The manufacturer will be able to include a choice of law-clause into its guarantee. Absent such clause, the applicable law will be determined by the private international law provisions of the forum.

#### **b) Law applicable to the extension of the arbitration clause**

As a second tier, the law applicable to the extension of the arbitration clause needs to be determined. No workable solution can be found in a *lex mercatoria* because the answer is closely related to the *lex causae*, i.e. the law applicable to the third party's substantive law claims. Only if the *lex causae* grants direct claims, the enforceability through arbitration becomes an issue. If the arbitration clause does not expressly or impliedly include the third party claimant, the extension of the arbitration clause to the third party claimant shall be determined by the law applicable to its substantive law claims. Because, in these authors' view, the substantive claims of the ultimate buyer against a remote seller sound in tort, the law applicable to the remote

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<sup>68</sup> Official Journal of the European Union of 31 July 2007, L 199/40. The Regulation will apply from 11 January 2009, Article 32.

<sup>69</sup> Anton K. Schnyder, Produkthaftung im grenzüberschreitenden Verkehr, in Weber/Thürer/Zäch (eds.), *Produkthaftungspflicht im europäischen Umfeld*, Schulthess: Zürich (1994), pages 115, 130.

<sup>70</sup> Articles 4-7 Hague Products Liability Convention; Article 5 Rome II Regulation; Article 135 PILA.

contract cannot govern these claims. Otherwise, the third party claimant would not only risk to be forced to submit its claim to arbitration but also to lose its direct claims because a foreign law chosen by the contracting parties might not recognize such direct claims.

### 3. The CISG in particular

In 1999, the French Supreme Court discussed whether the *action directe* could be applied to an international setting.<sup>71</sup> A French buyer purchased a thermostatic truck trailer from a French seller. The truck was equipped with a freezer that was manufactured by a US company and sold to the French seller via a French distributor. When the freezer broke down during a transport of nuts and fish causing damage to the French ultimate buyer, it sued the US manufacturer based on the manufacturer's express warranty. The French Supreme Court denied the ultimate buyer's direct action due to the application of the 1980 UN Convention on Contracts for the International Sale of Goods („CISG“)<sup>72</sup> to the relationship between the ultimate buyer and the manufacturer. The Court held that the rules of the CISG were designed exclusively to deal with the relationship between seller and buyer. Thus, the CISG could only be applied between the ultimate buyer and the manufacturer if they had concluded a sales contract directly between themselves. Because no sales contract existed between the ultimate buyer and the manufacturer, the buyer could not rely on the manufacturer's express warranty. In French doctrine, the ambit of this decision is disputed. Some authors confine this decision to cases where the ultimate buyer relies on a contractual guarantee by the manufacturer because the CISG only applies to sales contracts and not to independent guarantees.<sup>73</sup> Others argue that whenever the initial sales contract is governed by the CISG no *action directe* is admissible.<sup>74</sup>

Interestingly, in its 2008 decision, the French Supreme Court does not even mention this problem nor give any hint as to the applicable law. If no opting-out choice of law clause existed in the contract between the French importer and the New Zealand exporter, the CISG would have been

<sup>71</sup> Cass. civ. 1, 5 January 1999, CISG-online 431 (online available at <http://www.cisg-online.ch>), with note by Claude Witz, D. 1999, 383 et seq.; with note by Vincent Heuzé, Rev. crit. DIP 1999, 519.

<sup>72</sup> At present, 72 states have acceded to the CISG, including all important trading nations except for the UK, see [www.uncitral.org](http://www.uncitral.org).

<sup>73</sup> Vincent Heuzé, Rev. crit. DIP 1999, 519, 523 et seq.; Jochen Bauerreis, Le rôle de l'action directe contractuelle dans les chaînes internationales de contrats, Rev. crit. DIP 2000, 331, 352 et seq.; Bigot de la Touanne, D. Affaires 1999, 334 et seq.

<sup>74</sup> Witz, D. 1999, 383 et seq.; Jacques Raynard, RTD civ. 1999, 503 et seq.

applicable pursuant to Article 1(1)(a) CISG because both New Zealand and France are contracting states of the Convention. According to the view of the French Supreme Court in its 1999 decision, to determine the recourse of the French importer against the New Zealand manufacturer by way of *action directe* the relationship between them would be decisive; and this relationship would fall into the territorial sphere of application of the CISG.

In these authors' view, the CISG does not bar the admissibility of a direct recourse by the ultimate buyer against the first seller/manufacturer. This is because, according to Article 4 CISG, the Convention is only concerned with the contractual relationship between a seller and a buyer. The legal relationship between the ultimate buyer and the first seller/manufacturer is not of contractual but of a tortious nature because no contract exists between them. Only if the manufacturer grants an express guarantee to the ultimate buyer, which may be construed as an independent contract, the CISG might be applicable in spite of Article 2 CISG because the provisions of the CISG on non-conformity and cure may form an appropriate basis to address the legal issues arising from such guarantees.<sup>75</sup> In conclusion, the admissibility of any direct recourse between the ultimate buyer and the first seller is determined by the applicable domestic law. If the applicable law recognizes a direct action of the ultimate buyer against the first seller, as French law does, the fact that the contract between the first seller and its contract partner is governed by the CISG cannot bar its operation. Only the content and extent of liability may be derived from the CISG if the applicable domestic law qualifies the ultimate buyer's direct claim as contractual and refers to the remote contract that is governed by the CISG.

#### **4. Extension of arbitration clauses in the distributive chain**

Despite any dogmatic consideration under the applicable domestic law, the following interests need to be measured when discussing the question of whether an arbitration clause shall be extended to a non-signatory in the distributive chain. As pointed out by the French Supreme Court, in cases where the matter is inextricably intertwined, the principle of procedural efficiency and the objective of avoiding conflicting awards and judgments would generally call for a uniform solution including all possible claimants and defendants throughout the chain of contracts. However, with respect to a

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<sup>75</sup> In B2C-contracts, however, the CISG will mostly be excluded pursuant to Article 2(a) CISG because the manufacturer will know that its product will be bought by a consumer for personal, family or household use.

single member of the chain, it may be considerably faster and more efficient to just have one single defendant in the proceedings.<sup>76</sup> Only the intermediaries will have an interest in including both sides of the chain. Above all, what remains of the argument of procedural efficiency is contrasted by the principles of freedom of contract and privity, which require consent to bind any person to an arbitration agreement.<sup>77</sup>

As long as a non-signatory freely claims under contractual rights conferred upon it by two separate persons, it is legitimate to refer the matter to arbitration. The non-signatory may be treated as having impliedly consented to the arbitration clause with retrospective effect. This reasoning only applies to international chains of contracts in cases where the ultimate buyer was granted an express warranty or independent guarantee by the manufacturer. Such guarantees can be construed as a contract entered into directly between the manufacturer and the ultimate buyer or as a contract entered into between the manufacturer and the seller for the benefit of the ultimate buyer. In the case of a guarantee between the manufacturer and the ultimate buyer the latter only accepts the guarantee and thereby consents to the arbitration clause contained therein if it claims under the guarantee. In the case of a guarantee entered into between the manufacturer and the first seller for the benefit of the ultimate buyer, the latter again is only bound by the arbitration clause contained therein if it actually claims as a third party beneficiary thereof. By way of contrast, if the ultimate buyer resorts to the applicable products liability remedies it would not be bound by an arbitration clause included in the guarantee in either of the two scenarios. The only concern here is that the ultimate buyer who claims under such a guarantee might be obliged to arbitrate concurring tort or products liability claims as well.

Apart from the manufacturers' guarantees all other cases in which the ultimate buyer has contractual direct claims against upstream members of a chain of contracts (for example, the French *action directe*, implied warranties under US-American law, or contracts with protective effect on third parties under Austrian law) concern integral parts of the applicable products liability system because they remedy deficiencies of domestic tort law. It would thus be illegitimate to burden the ultimate buyer with an arbitration agreement to which it has not consented. This holds especially true if the ultimate buyer is a

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<sup>76</sup> See Joachim G. Frick, *Arbitration and Complex International Contracts*, Kluwer/Schulthess: Zürich (2001), page 235; Jens Kleinschmidt, *Die Widerklage gegen einen Dritten im Schiedsverfahren*, *SchiedsVZ* 2006, 142, 143.

<sup>77</sup> Jens Kleinschmidt, *Die Widerklage gegen einen Dritten im Schiedsverfahren*, *SchiedsVZ* 2006, 142, 146.

consumer because consumers deserve special protection by the state courts. Specifically in international cases, the consumer who is brought into an international arbitration might not be protected by the domestic law.<sup>78</sup> Additionally, if a claimant who relies on a contractual construction for its products liability claim is barred from asserting otherwise admissible tort claims as under the French doctrine of *non-cumul*, there is no justification to deny its rights to resort to state courts to enforce its rights. Statutory rights that set forth a manufacturer's strict liability in tort, such as claims under the domestic legislation implementing the European Council Directive 85/374/EEC of 25 July 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products, must not be burdened with arbitration clauses but may be brought in state courts.

This holds true if one reminds oneself that, despite all advantages, arbitration also encompasses significant disadvantages which the non-signatory has not accepted. The arbitration might take place abroad and the costs may be significantly higher. Furthermore, in state courts, legal aid might be accessible. In arbitration, the recovery of attorney fees might be impossible. The remedies for review of arbitral decision are usually limited. The non-signatory is forced to obey by unknown procedural rules. In conclusion, the ultimate buyer as a non-signatory should not be burdened with an international commercial arbitration clause if it relies on legal remedies under the applicable law on products liability. Only if the ultimate buyer chooses to claim under a contract concluded between the manufacturer and itself or the manufacturer and the first seller for its benefit shall the ultimate buyer be bound by the arbitration clause in this contract.

## 5. String arbitrations and other ways out

At present, arbitration clauses only extend to third parties in the distributive chain in the limited cases where the applicable domestic law so provides. Such an extension is known only in some jurisdictions and should neither be adopted as a principle of international commercial arbitration nor

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<sup>78</sup> In Switzerland, according to Article 114(2) PILA, a consumer may not in advance waive the mandatory forum at its place of domicile or habitual residence. Different opinions are held as to whether or not this provision applies to an arbitration agreement as well. In Germany, the only protection by imposing higher formal requirements to arbitration agreements with consumers pursuant to § 1031(5) German Code of Civil Procedure, will not apply in international cases. See Gerald Mäsch, *Schiedsvereinbarungen mit Verbrauchern*, in: Bachmann/Breidenbach/Coester-Waltjen/Heß/Nelle/Wolf (Hrsg.), *Grenzüberschreitungen, Beiträge zum Internationalen Verfahrensrecht und zur Schiedsgerichtsbarkeit*, Festschrift für Peter Schlosser zum 70. Geburtstag, Mohr Siebeck: Tübingen (2005), page 529 et seq.

by other states because the availability of such an extension is intertwined with the substantive solutions of domestic products liability law. Because the interests of the parties involved do not warrant the extension of arbitration clauses in the distributive chain, these authors take the view that the domestic developments in favor of such an extension shall be restricted to domestic cases within the respective jurisdictions.

The result of several single proceedings may be unduly burdensome as arbitration and litigation will take place concurrently between different members of one and the same distributive chain even though the material issues of fact and law will often be similar if not identical. It is however the necessary result of a legal reasoning that, as a starting point, regards contracts and arbitration clauses as bilateral agreements and private litigation and arbitration as two party proceedings. This situation can only be remedied upfront if all parties in the distributive chain agree to a master agreement or to identical terms in their respective sales contracts and arbitration clauses. Specifically, the party who is putting itself in the position of the middle man in two contracts may protect itself by providing so-called interlocking arbitration clauses.<sup>79</sup> These are arbitration clauses in two different contracts that refer to each other as to secure that, in case of a dispute, one tribunal is established with the power to hear the case of all three parties involved.<sup>80</sup> However, such upfront agreement will be impossible to achieve with the ultimate buyer if he is a consumer. Furthermore, it will be almost impossible to achieve such agreement if different interests are present, for example, the international part of the chain requires a different treatment than the domestic one. Only in cases of mere business to business transactions in a closed environment will it be possible to achieve an overall solution for all persons involved. This has been achieved by the introduction of so-called string arbitrations<sup>81</sup> in the commodity trade sector for sales on GAFTA's standard form contracts<sup>82</sup> that refer the contracting parties to arbitration under GAFTA No 125.<sup>83</sup> Rule 7.1 GAFTA Arbitration Rules provides that:

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<sup>79</sup> See Jens Kleinschmidt, *Die Widerklage gegen einen Dritten im Schiedsverfahren*, *SchiedsVZ* 2006, 142, 143.

<sup>80</sup> John Tackaberry and Arthur Marriot, in Fackaberry/Marriot (eds.), *Bernstein's Handbook of Arbitration and Dispute Resolution Practice*, Sweet & Maxwell: London (2003), Volume 1, para 2-650.

<sup>81</sup> Alan Redfern and Martin Hunter, *Law and Practice of International Commercial Arbitration*, Sweet & Maxwell: London (2003), para 3-75.

<sup>82</sup> The Grain & Feed Trade Association.

<sup>83</sup> The Arbitration Rules in their latest version are effective for contracts dated from 1 July 2007, <http://www.gafta.com>.

*If a contract forms part of a string of contracts which contain materially identical terms (albeit that the price may vary under each contract), a single arbitration determining a dispute as to quality and/or condition may be held between the first seller and the last buyer in the string as though they were parties who had contracted with each other.*

*Any award made in such proceedings shall, subject only to any right of appeal (...), be binding on all the parties in the string and may be enforced by an intermediate party against his immediate contracting party as though a separate award had been made pursuant to each contract.*

Other techniques are used in other types of arbitration, such as maritime arbitration. These include agreeing to or authoritatively selecting the same sole arbitrator; designating the same party appointed arbitrator by all claimants and respondents, respectively; consolidation; joinder;<sup>84</sup> or concurrent hearings.<sup>85</sup>

## VI. Summary

The use of multi-party arbitrations has increased the search of possible ways to extend arbitration agreement to third parties. In the international community of arbitration, the discussion has led to the development of groups of cases, one of which is referred to as “chains of contracts”. This article, however, has demonstrated that the extension of arbitration clauses is inextricably intertwined with the substantive law question of whether or not a remote buyer may take direct recourse against a remote seller upstream in a chain of contracts if no contract as between them exists. France, the USA, and Austria acknowledge such direct claims – with significant nuances though – and, in turn, advocate the extension of arbitration clauses through the distributive chain – yet, with significant nuances again. By contrast, the laws of Switzerland and Germany deny both. In the authors’ analysis, the hybrid contractual remedies employed in France, the USA, and Austria have, in large part, the function of remedying deficiencies of the respective

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<sup>84</sup> Nathalie Voser, *ibid*; Nathalie Voser/Andrea Meier, Joinder of Parties or the Need to (Sometimes) Be Inefficient, *Austrian Arbitration Yearbook 2008*, page 115 et seq., discussing the few possibilities to join third parties after the tribunal has been established; Andrea Meier, *Einbezug Dritter vor internationalen Schiedsgerichten*, Schulthess: Zürich (2007), discussing the issue of joinder under the assumption that an arbitration agreement that comprises all parties exists.

<sup>85</sup> Bruce Harris, in Tackaberry/Marriot (eds.), *Bernstein’s Handbook of Arbitration and Dispute Resolution Practice*, Sweet & Maxwell: London (2003), Volume 1, paras 11-078 et seq.; Alan Redfern and Martin Hunter, *Law and Practice of International Commercial Arbitration*, Sweet & Maxwell: London (2003), para 3-72 et seq.

domestic tort law, specifically redress for economic loss. Therefore, such claims form part of the domestic set of remedies for products liability which should not be burdened with international commercial arbitration clauses, above all not if the claimant is a consumer. Against this background, all possible claims by the ultimate buyer against a remote seller or manufacturer should be qualified, on the level of private international law, as tort claims but not as contractual claims. The applicable substantive law that determines whether the remote buyer has direct claims against a remote seller should then decide upon the extension of an arbitration clause in a remote contract as well. Only arbitration clauses contained in independent manufacturers' guarantees may bind the ultimate buyer if the latter chooses to claim under the guarantee. The remaining problem that single arbitration clauses in a chain of contracts cannot provide for a uniform solution throughout the chain can only be faced by contract drafting.

Ingeborg SCHWENZER & Florian MOHS, *Arbitration Clauses in Chains of Contracts*

**Summary**

To foster multi-party arbitrations French, US, and Austrian law allow, with significant nuances, for the extension of arbitration clauses through chains of contracts to claims by the ultimate buyer as a third party to the contract containing the arbitration clause against the first seller/manufacturer. The possibility of an extension of an arbitration clause in the case of a chain of contracts is inextricably intertwined with the substantive law question of whether or not the ultimate buyer may take direct recourse against a remote seller. Its admissibility cannot be regarded as a principle of international arbitration but is solely given if the domestic law of a jurisdiction that acknowledges the extension of an arbitration clause to a third party in a chain of contracts applies. Because no direct contractual relationship exists between the ultimate buyer and the remote seller, the buyer's direct claims sound in tort. The law applicable to these claims by virtue of the conflicts rules on products liability or tort should decide on the extension of the arbitration clause as well. Remaining procedural disadvantages for the middle-man in a chain of contracts can only be addressed by contract drafting.



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