A new judgment endorsing the extension of an arbitration agreement to non-signatories: the performance test plus the principle of good faith

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A recent decision of the Madrid High Court of Justice (**MHCJ**) has ruled on the extension of an arbitration agreement to companies that had not signed it.

In its judgment of 16 December 2014, the MHCJ resolved an action to set aside an award rendered by a sole arbitrator appointed by the Spanish arbitral institution CIMA. The MHCJ endorsed the extension of the arbitration agreement to non-signatories applying the test of the involvement of the latter in the performance of the contract containing the arbitration agreement and the principle of good faith.

Several major Spanish newspapers and magazines editors and distributors decided in 2008 to restructure their distribution businesses in the territory of Autonomous Community of Madrid. For such purposes, they entered into a shareholders agreement whereby they agreed to assign to a newly incorporated company (or to a fully owned subsidiary of the same) the distribution rights related to certain publications they respectively owned. The shareholders agreement contained an arbitration clause.

The joint venture companies were DIMA DISTRIBUCION INTEGRAL, S.A. (**DIMA**) and its wholly owned subsidiary GELESA GESTION LOGISTICA, S.L. (**GELESA**). The shareholders' editorial distribution rights and obligations were assigned to DIMA, which, in its turn, assigned them to GELESA.

Several years later a commercial dispute arose between one of the parties to the shareholders agreement (LOGINTEGRAL 2000, S.A.U. or **LOGINTEGRAL**) and DIMA and GELESA. The dispute related to the distribution fees these entities were charging LOGINTEGRAL. LOGINTREAL brought an action in accordance with the arbitration agreement.

DIMA and GELESA opposed from the outset that they were not a party to the arbitration agreement. They claimed they had not signed the agreement.

The arbitrator did not endorse their allegation. He considered that the arbitration agreement could be extended to non-signatories based on three main reasons:

- The shareholders agreement provided for the assignment of the editorial distribution rights and obligations to an entity that was not a party to the agreement (the JV-company DIMA); therefore, it would be illogical -as it would render the arbitration agreement ineffective- that the arbitration agreement did not bind the JV-company as well.

- The fact that the arbitration agreement had not been signed by DIMA and GELESA did not mean that these companies should be considered third parties; they formed a group of companies that was the instrument for carrying out the activities contemplated in the shareholders agreement.

- The principles of good faith and consistency with one's own acts supported this conclusion. DIMA and GELESA claimed that they had acted in accordance with the

shareholders agreement in their commercial relationship with LOGINTEGRAL and, therefore, they recognized they were bound by it. It would be inconsistent to sustain that they were bound by the shareholders contract but not by the arbitration agreement included therein.

The MHCJ recognized that the possibility to apply an arbitration agreement to non-signatories is a very much discussed one. In fact, the Spanish Supreme Court has adopted different views on this respect.

In some cases, the Supreme Court has denied the so-called extension of the arbitration agreement to non-signatories. For instance, this has been its position when considering an arbitration agreement included in the by-laws of a company that was intended to be extended to its directors in a lawsuit brought against the company and its directors. Similarly, it also rejected the application of the arbitration agreement contained in a condominium's by-laws to solve disputes between co-owners to those arising between the condominium and the co-owners.

However, the Supreme Court has adopted the opposite approach when the non-signatory was directly involved in the performance of the contract which contained the arbitration agreement. Following the Supreme Court's reasoning, this possibility derives from the preamble of the Spanish Arbitration Act, which refers to "arbitration agreements by reference" (i.e. those that, although not included in the main contractual document, are deemed to be incorporated by reference).

Following the latter doctrine and the one laid down in its own judgments, the MHCJ distinguished two types of circumstances where a third party may be caught by an arbitration agreement:

- The most conspicuous cases of extension of an arbitration agreement are those in which a third party subrogates in the main agreement containing the arbitration clause pursuant to a specific assignment agreement or to a merger between two companies.

- However, an arbitration agreement can also be extended to a non-signatory that has played a key role in the contractual relationship, due to its direct involvement in the performance of the contract or because it is the beneficiary of the rights deriving from the main agreement.

After a detailed analysis of the particularities of the shareholders agreement and the activities conducted by the parties, the MHCJ reached the conclusion that the test of the second set of circumstances had been met in the case at hand.

Indeed, according to the MHCJ, it was clear that the shareholders agreement could not have been implemented without DIMA's and GELESA's involvement, as, in fact, the very purpose of DIMA and GELESA was the performance of the joint venture. The purpose of the shareholders agreement was not limited to the incorporation of the joint venture, as submitted by the applicants. The parties' will went further to restructure their editorial distribution activities in a more efficient way through a fully owned joint venture company. It was with such goal in mind that the shareholders assigned their editorial distribution rights and obligations to the joint venture company.

All the above implied that the legal relationship between the parties and the manner in which they allocated their rights and obligation resulted in a natural extension of the arbitration agreement to DIMA and GELESA.

As the arbitrator had done in the award, the MHCJ applied the principle of good faith to reinforce its conclusion. During all the years the shareholders agreement had been in force, DIMA had never opposed to be bound by its clauses; it was only when the arbitration proceedings started, that it rejected the application of the arbitration clause.

The MHCJ also found that the claim of the applicants would have resulted in an illogical result, namely the possible existence of two parallel proceedings over the same disputes: judicial proceedings between the joint venture companies and the parties to the shareholders agreement, on the one hand, and arbitration between the latter, on the other.

Therefore, the MHCJ dismissed the action to vacate the award.

This case confirms the non-formalistic approach to arbitration of Spanish courts, also in a complex question like the one at hand.