LCA 4716/04

Hotels.com

v

1. Zuz Tourism Ltd

2. Hotels Online Ltd (formal respondent)

The Supreme Court sitting as the Court of Civil Appeals

[7 September 2005]

Before Vice-President M. Cheshin and Justices A. Grunis, E. Arbel

Application for leave to appeal the decision of the Jerusalem District Court (Judge M. Drori) on 4 April 2004 in CApp (Jer) 1929/02.

Facts: The applicant and the first respondent entered into an exclusive marketing agreement in February 2000. This agreement contained an arbitration clause stating that disputes between the parties would be resolved by arbitration which shall take place in Texas. In June 2002, the first respondent filed an action in Israel against the applicant and the second respondent, on the grounds that the second respondent was marketing the services of the applicant contrary to the agreement. The applicant filed a motion for a stay of proceedings on account of the arbitration clause in the agreement. The District Court denied the application, and the applicant applied for leave to appeal the District Court's decision. The application was heard as an appeal.

The main question before the Supreme Court was whether the joinder of the second respondent, who was not a party to the agreement containing the arbitration clause, justified refusing a stay of proceedings on the ground that otherwise the litigation would be split between two proceedings. Under Israeli law, the court has discretion to refuse a stay of proceedings in such a case with regard to domestic arbitration agreements. The question before the court was whether the court had such discretion in a case of an international arbitration agreement that is subject to an international

convention. The parties agreed that the arbitration clause was subject to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958. This convention, known also as the New-York convention, was ratified by Israel in 1959.

Held: The Israeli court does not have the same discretion to stay proceedings under s. 6 of the Arbitration Law regarding an international arbitration agreement as it does under s. 5 of the Arbitration Law regarding a domestic arbitration agreement. Under s. 6 of the Arbitration Law together with art. 2(3) of the New York Convention, the court is required to stay proceedings unless it finds that the arbitration agreement 'is null and void, inoperative or incapable of being performed.' It cannot refuse a stay of proceedings on additional discretionary grounds. The existence of a litigant who is not a party to the arbitration agreement does not make the agreement 'null and void, inoperative or incapable of being performed.' Consequently, the court is required to order a stay of proceedings in such circumstances.

Application granted. Appeal allowed.

Legislation cited:

Arbitration Law, 5728-1968, ss. 5, 6.

Israeli Supreme Court cases cited:

CA 6796/97 *Yaakov Berg & Sons (Furniture) Ltd v. Berg East Importers Ltd* [2000] IsrSC 54(1) 697. [1]

LA 201/85 *Nitzanei Oz Workers Cooperative Agricultural Settlement Ltd v. Balhassan* [1985] IsrSC 39(3) 136. [2]

LCA 985/93 *Alrina Investment Corporation v. Barki Feta Humphries (Israel) Ltd* [1994] IsrSC 48(1) 397. [3]

CA 307/71 *Unico Reutman Public Works Co. Ltd v. Shimshon Insurance Co. Ltd* [1972] IsrSC 26(1) 368. [4]

CA 4601/02 *Rada Electronic Industries Ltd v. Bodstray Co. Ltd* [2004] IsrSC 58(2) 465. [5]

LCA 1407/94 *Mediterranean Shipping Co. S.A. v. Crédit Lyonnais (Suisse) S.A.* [1994] IsrSC 48(5) 122. [6]

CA 778/03 *Inter-Lab Ltd v. Israel Bio Engineering Project* [2003] IsrSC 57(5) 769. [7]

Israeli District Court cases cited:

CC (TA) 842/87 *General Electric Corp. of New York v. Migdal Insurance Co. Ltd* (unreported). [8]

CApp (Hf) 213/99 *Egnatia Shipping Limited v. Israel Discount Bank Ltd* (unreported). [9]

CA (TA) 3060/03 *University of Leicester v. Cohen* (unreported). [10]

American cases cited:

Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974). [11]

Mitsubishi Motors Corporation. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985). [12]

Riley v. Kingsley Underwriting Agencies Ltd., 969 F. 2d 953 (1992). [13]

Intergen N.V. v. Grina, 344 F. 3d 134 (2003). [14]

Canadian cases cited:

City of Prince George v. A.L. Sims & Sons Ltd. (1995) 61 B.C.A.C. 254 (B.C.C.A.). [15]

BWV Investments Ltd. v. Saskferco Products Inc. [1995] 119 D.L.R. (4th) 577 (Sask. C.A.). [16]

Kaverit Steel and Crane Ltd. v. Kone Corp. (1992) 120 A.R. 346. [17]

English cases cited:

Lonrho Ltd v. Shell Petroleum Company Ltd, [18] unreported decision of High Court of Justice, Chancery Division, on 31 January 1978; see Yearbook, Commercial Arbitration, vol. IV–1979, 320.

Etri Fans Ltd v. NMB (UK) Ltd [1987] 2 All ER 763. [19]

For the applicant — E.A. Naschitz.

For the respondents — D. Eidelaman, R. Preiss.

JUDGMENT

Justice A. Grunis

1. This is an application for leave to appeal the decision of the Jerusalem District Court of 4 April 2004 (the honourable Judge M. Drori), in which the applicant's motion for stay of proceedings in an action filed by the first respondent against the applicant and against the second respondent, was denied.

The factual background

2. The applicant (hereafter — hotels.com) is a foreign company registered in the United States. Its business is marketing tourism services, and especially hotel rooms, on the Internet. It should be noted that the former name of hotels.com was Hotel Reservations Network Inc. The first respondent (hereafter — Zuz) and the second respondent (hereafter — Hotels Online) are Israeli companies that do business in the field of tourism. On 29 February 2000, hotels.com and Zuz entered into an agreement in which it was stated that Zuz would market in Israel the tourism services offered by hotels.com, in return for a certain commission (hereafter — the agreement). Clause 11 of the agreement includes an arbitration clause, according to which disputes between the parties with regard to the agreement shall be decided

within the framework of an arbitration proceeding, which will take place in the State of Texas in the United States (hereafter — the arbitration clause). Because of the importance of the arbitration clause for our purposes, we shall cite it in full:

> 'The parties agree that any dispute under this agreement will be subject to binding arbitration under the commercial rules of the American Arbitration Association. The arbitration shall be conducted in Dallas County, Texas, before neutral arbitrators.'

The agreement does not include an express provision with regard to the law governing the agreement or the arbitration proceeding, but refers to the rules of the American Arbitration Association. In clause 12 of the agreement, it is stated that the Internet site that Zuz will maintain under the agreement shall be the only site in Israel in the Hebrew language through which hotels.com will market its services during the term of the agreement:

> 'Zuz Tourism Ltd will be the only Internet site in Hebrew in Israel that we will sign on to integrate with per length of contract [*sic*]. This is from date of signed contract 29.2.00.'

3. According to Zuz, it discovered in May 2002 that the services of hotels.com were being marketed on the Internet site of Hotels Online. Consequently, on 10 June 2002 Zuz filed an action in the Jerusalem District Court against hotels.com and against Hotels Online, in which it petitioned for declaratory relief that the aforesaid marketing activity constitutes a breach of the agreement. Zuz also petitioned for the relief of specific enforcement and for a permanent injunction prohibiting the marketing of the services of hotels.com on any Internet site other than that of Zuz. On the same day, Zuz also applied for temporary relief according to which, *inter alia*, the marketing of the services of hotels.com on the Internet site of Hotels Online be prohibited. For its part, hotels.com filed an application for a stay of proceedings on account of the arbitration clause in the agreement. On 4 April 2004, the District Court denied both the application for temporary reliefs and the application for a stay of proceedings. In the decision it was stated that a

stay of proceedings against hotels.com was likely to result in an undesirable procedural split, in view of the fact that Hotels Online was not a party to the arbitration clause and thus no stay of proceedings could be ordered with regard to it. This split and the concern that conflicting findings would be reached in the two different proceedings, led to the decision of the District Court not to grant the application for a stay of proceedings. Admittedly, the lower court emphasized that the relevant provision of law in this case was s. 6 of the Arbitration Law, 5728-1968 (hereafter — the Arbitration Law or the law). This is because of the application of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958, enacted in New York in 1958. Notwithstanding, it was held that, like s. 5 of the Arbitration Law, s. 6 of the law also gave the court discretion not to stay the proceedings in cases like this one. The application for leave to appeal is directed against the denial of the application for a stay of proceedings. Within the application, hotels.com also requested a stay of proceedings against Hotels Online. In August 2004, after the application for leave to appeal was filed, hotels.com applied to the American Arbitration Association in the United States with a request to file an action against Zuz under the arbitration clause (hereafter — the arbitration request). On 19 September 2004, the District Court gave temporary relief, according to which hotels.com was prohibited from continuing the arbitration proceedings in the United States. On 14 October 2004, this court (Justice Y. Türkel) issued an order that the aforesaid relief would remain in force until the decision was given in the application for leave to appeal, and that Zuz's action would be stayed until then. We decided to hear the application as if leave had been granted and an appeal had been filed pursuant to the leave granted.

The legal framework

4. The rule is that consent to submit any matter to arbitration does not negate the subject-matter jurisdiction of the court to hear the matter (CA 6796/97 *Yaakov Berg & Sons (Furniture) Ltd v. Berg East Importers Ltd* [1], at p. 706; LA 201/85 *Nitzanei Oz Workers Cooperative Agricultural Settlement Ltd v. Balhassan* [2], at p. 139). Notwithstanding, when an action

is filed in court on a matter that was the subject of an arbitration agreement, the court has the power to stay the proceedings in the action. Thereby, a breach of the arbitration agreement is prevented. The main provision of the law that governs the issue of a stay of proceedings is found in s. 5 of the Arbitration Law:

> '5. (a) If an action is filed in court with regard to a dispute that it was agreed to submit to arbitration, and a litigant who is a party to the arbitration agreement applies to stay the proceedings in the action, the court shall stay the proceedings between the parties to the agreement, provided that the applicant was willing to do everything necessary to carry out the arbitration and continue it, and he is still prepared to do so.
>
> (b) An application for a stay of proceedings may be filed in a statement of defence or in another way, but not later than the day on which the applicant first argued on the merits of the matter in the action.
>
> (c) The court may refuse to stay the proceedings if it finds a special reason why the dispute should not be adjudicated in arbitration.'

Thus we see that when the conditions included in the section are fulfilled, the court will, as a rule, stay the proceedings between the parties to the arbitration agreement, unless it finds that there is a special reason why the dispute should not be adjudicated in arbitration. When considering whether to order a stay of proceedings in the action, the court may take various considerations into account (for a discussion of these considerations, see S. Ottolenghi, *Arbitration — Law and Procedure* (third extended edition, 1991), at pp. 126-145). In this context, the question arises as to how the court should act in cases where an application to stay proceedings is filed by some of the defendants who are a party to an arbitration agreement with the plaintiff, when there are other defendants who are not a party to this agreement. The question arises because it is not possible to compel someone who is not a

party to the arbitration agreement to take part in the arbitration proceeding. Therefore, granting the application to stay the proceedings in such a case will lead to a split in the proceedings: the dispute between the plaintiff and the defendants who are party to the arbitration agreement will be adjudicated within the framework of an arbitration proceeding, whereas the dispute between the plaintiff and the other defendants (those who are not parties to the arbitration agreement) will be adjudicated before the court. Such a split may lead to conflicting conclusions and findings and is also not desirable for practical reasons. On the other hand, denying the application for a stay of proceedings will allow the breach of the contractual consent between the parties to the arbitration agreement. In the case law of this court, it is possible to find traces of different approaches with regard to this issue. In a decision from 1993 that addressed this issue, it was held, by a majority, that the court should examine the existence of two conditions (which were named 'the two-stage test'): (a) is the joinder to the action of the defendant who is not a party to the arbitration agreement a genuine one, meaning that it was not done in order to evade the obligation to settle the dispute within the framework of arbitration (procedural necessity); (b) does holding the proceedings within one framework, without a split, constitute a condition for the plaintiff being able to obtain effective relief (substantive necessity). If the court is persuaded that both of the aforesaid questions should be answered in the affirmative, then there exists a special reason not to order a stay of the proceedings (the majority opinion in LCA 985/93 *Alrina Investment Corporation v. Barki Feta Humphries (Israel) Ltd* [3]; for another approach, see the minority opinion of Justice M. Cheshin in *Alrina Investment Corporation v. Barki Feta Humphries (Israel) Ltd* [3] and also CA 307/71 *Unico Reutman Public Works Co. Ltd v. Shimshon Insurance Co. Ltd* [4]; for a similar problem with regard to an exclusionary forum selection clause, see CA 4601/02 *Rada Electronic Industries Ltd v. Bodstray Co. Ltd* [5], at pp. 478-479).

5. An additional provision concerning a stay of proceedings on account of an arbitration agreement is found in s. 6 of the Arbitration Law:

> 'If an action is filed in court with regard to a dispute that it was agreed to submit to arbitration, and the arbitration is subject to an international convention to which Israel is a party, and the convention contains provisions concerning a stay of proceedings, the court shall exercise its power under section 5 *in accordance with those provisions and subject thereto*' (emphasis added).

As can be seen from the wording of the aforementioned section, it does not apply to every case of an application for a stay of proceedings based on the existence of an arbitration agreement. Its application is limited merely to those cases where the arbitration is subject to an international convention to which Israel is a party, and that convention contains provisions concerning a stay of proceedings. With regard to such cases, the section provides that the power of the court vis-à-vis the issue of a stay of proceedings, as set out in s. 5, shall be exercised in accordance with the provisions of the convention and subject thereto. In other words, s. 6 of the law refers to the provisions of the convention concerning a stay of proceedings, and grants them preferential status to the provision of s. 5 of the Arbitration Law.

6. In our case, there is no dispute between the parties that the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 (hereafter — the convention or the New York Convention) applies to the arbitration clause. This convention, which was enacted in New York in 1958, was intended to replace the Geneva Protocol on Arbitration Clauses, 1923 (Treaties 4, p. 67) (hereafter — the Geneva Protocol). The convention was ratified by Israel in 1959 (the text of the convention was published in Treaties 10, p. 1). The relevant provision for our purposes is art. 2 of the convention:

> 'Article II
>
> 1. Each Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which

> may arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration.
>
> 2. The term "agreement in writing" shall include an arbitral clause in a contract or an arbitration agreement, signed by the parties or contained in an exchange of letters or telegrams.
>
> 3. The court of a Contracting State, when seized of an action in a matter in respect of which the parties have made an agreement within the meaning of this article, *shall*, at the request of one of the parties, *refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed*' (emphases added).

From the wording of art. 2(3) of the convention it can be seen that the court is required to order the referral of the parties to an arbitration proceeding, unless one of the three exceptions is satisfied: the arbitration agreement is null and void, inoperative or incapable of being performed.

The scope of the dispute

7. Zuz filed its action both against hotels.com and against Hotels Online. The agreement between Zuz and hotels.com includes an arbitration clause, according to which disputes concerning the agreement will be decided within the framework of an arbitration proceeding that will take place in the State of Texas in the United States. On the other hand, there is no arbitration agreement between Zuz and Hotels Online. The lower court reached the conclusion that the joinder of Hotels Online to the action satisfied the two-stage test adopted in *Alrina Investment Corporation v. Barki Feta Humphries (Israel) Ltd* [3]. In this respect, it was held that the procedural necessity of joining Hotels Online to the action arose from the fact that it was the party that allegedly violated the exclusive right granted to Zuz under the agreement. The lower court also held that splitting the proceedings — in such a way that the dispute between Zuz and hotels.com would be adjudicated in an arbitration proceeding in the United States, whereas the dispute between

Zuz and Hotels Online would be adjudicated before the courts in Israel — may lead to conflicting determinations and thereby prejudice Zuz's right to obtain effective relief. We are prepared to assume, without ruling on this issue, that the District Court was right in determining that there is both a procedural necessity and a substantive necessity for joining Hotels Online to Zuz's action. Had the only provision of law relevant to our case been the one in s. 5 of the law, then in view of the aforesaid assumption and on the basis of the case law rule laid down in the majority opinion in *Alrina Investment Corporation v. Barki Feta Humphries (Israel) Ltd* [3], it would apparently be necessary to reach the conclusion that there is no basis for staying the proceedings against hotels.com. However, in the case before us the provisions included in s. 6 of the law and in art. 2(3) of the convention apply. Consequently, according to s. 6 of the law, the court is required to determine the issue of stay of proceedings in accordance with the provisions of the convention. The question that arises in our case is therefore as follows: in cases where s. 6 of the law and art. 2(3) of the convention apply, is the court competent to refrain from staying proceedings because of the joinder of a defendant who is not a party to the arbitration agreement? In order to answer this question, we are required to consider two secondary questions that are interrelated: *first*, do the three exceptions included in art. 2(3) of the convention constitute a closed list? In other words, is the court compelled to stay the proceedings in every case where none of the three aforesaid exceptions apply? *Second*, does the fact that there is a defendant who is not a party to the arbitration agreement fall within one of the three exceptions in art. 2(3) of the convention? Let us now turn to consider these issues.

The scope of discretion given to the court under s. 6 of the law together with art. 2(3) of the convention

8. The question of the scope of discretion given to the court under s. 6 of the law together with art 2(3) of the convention was considered in the judgment of LCA 1407/94 *Mediterranean Shipping Co. S.A. v. Crédit Lyonnais (Suisse) S.A.* [6]. According to the approach of Justice M. Cheshin, the referral of the parties to arbitration under the aforesaid provisions is an

obligatory referral. This means that when the conditions set out in s. 6 of the law and in art. 2(3) of the convention are satisfied, the court is compelled to stay the proceedings and refer the parties to an arbitration proceeding, unless one of the exceptions set out in art. 2(3) of the convention applies (*ibid*. [6], at pp. 129-132). On the other hand, Justice T. Strasberg-Cohen questioned 'whether the interpretation that denies the court discretion is the only possible and proper one' (*ibid.* [6], at p. 128). Since it was not necessary to rule on that issue within the framework of those proceedings, she left undecided the question whether the list of exceptions in art. 2(3) of the convention constitutes a closed list (*ibid*. [6], at pp. 127-128). It should also be noted that there are conflicting decisions of the District Courts on this issue (see CC (TA) 842/87 *General Electric Corp. of New York v. Migdal Insurance Co. Ltd* [8]; CApp (Hf) 213/99 *Egnatia Shipping Limited v. Israel Discount Bank Ltd* [9]; for a different approach, see CA (TA) 3060/03 *University of Leicester v. Cohen* [10]).

9. In order to establish the scope of the court's discretion under s. 6 of the law in conjunction with art. 2(3) of the convention, let us first turn to the language of these provisions. Section 6 of the law provides that the power of the court under s. 5 of the law — which deals, as aforesaid, with stay of proceedings — shall be exercised in accordance with and *subject to* the provisions of the convention governing the arbitration (para. 5 *supra*). Article 2(3) of the convention provides in mandatory language that the court 'shall… refer' the litigants to arbitration, unless one of the three exceptions listed in the article is satisfied (para. 6 *supra*). It would appear that the manner in which the two provisions are worded leads to the conclusion that if one of the three exceptions mentioned in art. 2(3) of the convention is not satisfied, then as a rule the court is required to order a stay of the proceedings. It should be noted that art. 4 of the Geneva Protocol, which includes a similar provision to the one in art. 2(3) of the convention, is also worded in a way that compels the court to refer the dispute to arbitration when the conditions set out therein are satisfied. Moreover, it appears that, according to the wording of the two aforesaid provisions, a situation in which there is a litigant who is not a party

to the arbitration agreement does not fall within any of the three exceptions in art. 2(3) of the convention. As I shall clarify later, I am of the opinion that considerations concerning the purpose of s. 6 of the Arbitration Law and of art. 2(3) of the convention lead to a similar conclusion.

10. One of the main purposes of the convention is effective enforcement of international arbitration agreements, by means of setting uniform standards according to which such agreements will be enforced (A.J. van den Berg, *The New York Arbitration Convention of 1958 — Towards a Uniform Judicial Interpretation* (1981), at p. 4; regarding the importance of giving a uniform interpretation to the convention, see van den Berg at pp. 1-6). The concern that was expressed in this regard is that courts of the states that are parties to the convention will be deterred from sending local defendants to litigate within the framework of an arbitration proceeding in a foreign state, and for that reason will tend to refrain from honouring international arbitration agreements (see *Scherk v. Alberto-Culver Co.* [11], at footnote 15, and the references cited there). Such a situation is likely to cause substantial difficulty in achieving certainty, which is an essential component in the realm of international commerce. It is also likely to provide an incentive for parties to turn to the courts in their own country, in order to bring about a situation in which the dispute is adjudicated in the forum that is preferable to them. This 'competition' may result in conflicting decisions of courts in different countries, thereby increasing uncertainty and creating an undesirable situation. The aforesaid reasons led the United States Supreme Court to distinguish between international arbitration agreements, at least those that concern the commercial sphere, and arbitration agreements that do not have an international aspect. It was held that there are situations where international arbitration agreements should be honoured, even in cases where there would be no basis for honouring identical domestic arbitration agreements (*Scherk v. Alberto-Culver Co.* [11]; *Mitsubishi Motors Corporation. v. Soler Chrysler-Plymouth, Inc.* [12]). Against this background, let us now turn to examine comparative law in so far as it concerns the interpretation of art. 2(3) of the convention.

11. It would appear that there is a real similarity in the way in which art. 2(3) of the convention has been interpreted in many of the common law countries. The rule that has been laid down in this respect is that the clause is of a binding character. This means that if none of the three exceptions mentioned in the article apply, the court is required to stay the proceedings and refer the parties to an arbitration proceeding, without exercising any discretion in the matter (van den Berg, *The New York Arbitration Convention of 1958 — Towards a Uniform Judicial Interpretation*, *supra*, at pp. 135-137). The aforesaid rule is followed, *inter alia*, in the United States (*Riley v. Kingsley Underwriting Agencies Ltd.* [13]; *Intergen N.V. v. Grina* [14]), Canada (*City of Prince George v. A.L. Sims & Sons Ltd*. [15]; *BWV Investments Ltd. v. Saskferco Products Inc.* [16]) and England (*Lonrho Ltd v. Shell Petroleum Company Ltd* [18]). We should also point out that until the enactment of the Arbitration Act 1996, there existed in England a clear distinction, for the purposes of the issue of stay of proceedings, between domestic arbitration agreements and international arbitration agreements. Whereas with regard to domestic arbitration agreements the court had discretion not to order a stay of proceedings, with regard to international arbitration agreements the courts were obliged to order a stay of proceedings, unless one of the exceptions mentioned in the convention was satisfied. In 1996 the law was changed and now the English courts do not have discretion on the question of stay of proceedings even with regard to domestic arbitration agreements (D. Sutton and J. Gill, *Russell on Arbitration* (twenty-second edition, 2003), at pp. 18-19; with regard to the rule in England before the 1996 amendment, see M.J. Mustill and S.C. Boyd, *Commercial Arbitration* (second edition, 1989) at pp. 462-483).

Moreover, in addition to the rule that art. 2(3) of the convention is of a binding character, it has been held that a situation in which one or more of the defendants is not a party to the arbitration agreement does not fall within any of the three exceptions in art. 2(3) of the convention. In other words, the existence of a litigant who is not a party to the arbitration agreement does not make the arbitration agreement that exists between all or some of the other

litigants null and void, inoperative or incapable of being performed. Therefore, in a situation of this kind, the court is obliged to order a stay of proceedings with regard to those litigants who are party to the arbitration agreement (Yearbook, Commercial Arbitration, vol. XXVIII–2003, 637-639; van den Berg, *The New York Arbitration Convention of 1958 — Towards a Uniform Judicial Interpretation*, *supra*, at pp. 161-168). This rule is followed, *inter alia*, in Canada (*Kaverit Steel and Crane Ltd. v. Kone Corp*. [17]; *City of Prince George v. A.L. Sims & Sons Ltd*. [15]) and in England (*Lonrho Ltd v. Shell Petroleum Company Ltd* [18]).

12. We see that considerations of certainty and the fear of international arbitration agreements not being honoured due to a preference for local litigants' interests, have led foreign courts to adopt an interpretational approach that restricts the scope of discretion with regard to a stay of proceedings vis-à-vis international arbitration agreements. In this respect, we should mention two additional considerations that are unique to the situation in which one of the litigants is not a party to the arbitration agreement: *first*, a significant number of arbitration agreements that stipulate to the holding of an arbitration in a foreign state also include a clause that applies the law of that state (or another foreign law) to the matter. If a stay of proceedings is not given with regard to such agreements because of the existence of an additional defendant who is not a party to the arbitration agreement, a question is likely to arise with regard to the law that should be applied to the dispute between the plaintiff and the defendant who is a party to the arbitration agreement. If we say that the court in Israel is required to apply the foreign law, then there will occur a split of a different kind to the one we mentioned: the dispute between the plaintiff and the defendant who is a party to the arbitration agreement will be decided according to the foreign law, whereas the dispute between the plaintiff and the defendant who is not a party to the arbitration agreement will be decided according to Israeli law. In such a situation there is a concern that conflicting decisions will be made, and therefore the justification underlying the refusal to stay proceedings is significantly weakened. On the other hand, if we rule that the whole matter

should be decided in accordance with Israeli law, we shall find ourselves significantly changing the material rights of the parties to the arbitration agreement, in addition to giving judicial approval to the breach of the arbitration agreement. This increases the fear of uncertainty with regard to international arbitration agreements (for a discussion of this issue with regard to internal arbitration agreements, see the minority opinion of Justice M. Cheshin in *Alrina Investment Corporation v. Barki Feta Humphries (Israel) Ltd* [3], at pp. 406-408). Admittedly, in this case there is no express provision in the agreement concerning the applicable law, but we should remember that our ruling articulates a general principle. Moreover, Zuz does not claim that Israeli law governs the agreement. Even if the claim had been made, it would have been difficult to accept it. Agreeing to hold the arbitration in Texas certainly does not imply that Israeli law is applicable. *Second*, refraining from staying proceedings despite the existence of an international arbitration agreement, for the reason that one or more of the defendants are not party to the arbitration agreement, may create an additional difficulty. Admittedly, as a result of declining to stay the proceedings, a split of the case will be avoided, in the sense that the plaintiff's action against the defendant who is a party to the arbitration agreement — which should have been adjudicated within the framework of arbitration — will be decided together with the action against the defendant who is not a party to that agreement. However, this cannot prevent the defendant who is a party to the arbitration agreement from acting under the agreement and filing an action with regard to precisely the same matter before the arbitrator in the foreign country. This is what hotels.com has done in the case before us. The result would be that the dispute between the parties to the arbitration agreement would be split and heard before two different tribunals: the action of the one party will be heard by the courts in Israel, whereas the action of the other party will be decided by the arbitrator abroad. It thus follows that refraining from staying the proceedings, albeit preventing a split in one respect, creates a split of the proceedings in another respect, with all that this implies. In order to prevent this new split, the court in Israel will be required to issue an injunction

against the defendant who is a party to the arbitration agreement, prohibiting him from continuing his action before the arbitrator and compelling him to litigate also *as a plaintiff* before the courts in Israel. This would result in another significant departure from the contractual consent between the parties to the arbitration agreement (with regard to an injunction restraining foreign proceedings, see CA 778/03 *Inter-Lab Ltd v. Israel Bio Engineering Project* [7]).

13. I am of the opinion that the aforementioned considerations lead to the conclusion that the court's scope of discretion under s. 6 of the law, together with art. 2(3) of the convention, is significantly narrower than its scope of discretion under s. 5 of the law. When dealing with arbitration that is governed by the convention and the relevant requirements in s. 6 of the law and art. 2(3) of the convention (such as the requirement that the stay of proceedings has been requested by a litigant who is a party to the arbitration agreement) are satisfied, as a rule the court is required to order a stay of proceedings unless one of the three exceptions in the aforesaid art. 2(3) exists (for support for this position, see Ottolenghi, at pp. 150-156; for a discussion of the question of the existence of the requirements listed in s. 6 of the law and in art. 2(3) of the convention, cf. *Mediterranean Shipping Co. S.A. v. Crédit Lyonnais (Suisse) S.A.* [6]). This result is consistent with the language of the law and with the language of the convention. It is also consistent with one of the main purposes of art. 2(3) of the convention: promoting legal certainty with regard to international arbitration agreements, by removing the concern that courts in the various countries will tend to prefer the interests of the local litigant, and therefore will refrain from honouring international arbitration agreements that stipulate to legal proceedings in a foreign country. I am prepared to assume that there may be exceptional cases in which the court may refuse to stay proceedings, even if none of the aforesaid three exceptions is satisfied. However, these cases will be rare (cf. *Etri Fans Ltd v. NMB (UK) Ltd* [1987] 2 All ER 763). It should be emphasized that our decision in these proceedings concerns only arbitrations that are governed by the New York Convention. It is possible that in certain cases another

international convention will apply. As stated above, s. 6 of the law provides that when the arbitration is governed by an international convention to which Israel is a party, and the convention includes provisions concerning a stay of proceedings, the court shall exercise its authority under s. 5 of the law 'in accordance with those provisions and subject thereto'.

14. Indeed, no one disputes that there are weighty reasons that support a refusal to stay proceedings in cases where some of the litigants are not parties to the arbitration agreement, at least in certain circumstances (for details of the reasons, see the minority opinion of Justice M. Cheshin in *Alrina Investment Corporation v. Barki Feta Humphries (Israel) Ltd* [3], at p. 405). These reasons are what led the majority in *Alrina Investment Corporation v. Barki Feta Humphries (Israel) Ltd* [3] to the conclusion that within the framework of s. 5 of the law, the court may, in circumstances of this kind, refuse to stay proceedings notwithstanding the existence of an arbitration agreement, provided that the two-stage test is satisfied (see para. 4 *supra*). In any case, it should be remembered that we are concerned with arbitration agreements that are subject to the convention, and are therefore governed by s. 6 of the law, and not with domestic arbitration agreements, which are governed by s. 5 of the law. With regard to international arbitration agreements it should be held that the fact that there is a litigant who is not a party to the arbitration agreement does not fall within any of the three exceptions in art. 2(3) of the convention. In other words, this circumstance does not constitute, as a rule, a reason for the court to refuse to order a stay of proceedings, in so far as arbitration agreements that fall within the scope of s. 6 of the law are concerned. The District Court therefore erred in refusing to stay the proceedings for the reason that Hotels Online, which is one of the defendants in Zuz's action, is not a party to the arbitration clause.

Additional arguments

15. In its response to the application for leave to appeal, Zuz raises additional arguments that do not concern the question of the interpretation of s. 6 of the law and art. 2(3) of the convention, which we have discussed up to this point. I shall address two of these arguments, which require

consideration. According to Zuz, hotels.com acted in bad faith when it submitted the arbitration request in the United States. As aforesaid, this request was submitted in August 2004, after the lower court gave its decision and after the application for leave to appeal was filed before us. Despite this, within the arbitration request hotels.com refrained from mentioning the existence of the proceedings taking place in Israel, including the decision of the District Court. According to the argument, the aforesaid manner of conduct is sufficient to lead to the denial of the application of hotels.com. Admittedly, in certain circumstances the appeals court may take into account events that took place after the decision of the lower court was issued. I am also prepared to assume that the duty of good faith extends also to proceedings under ss. 5 and 6 of the law (see the opinion of President M. Shamgar in *Mediterranean Shipping Co. S.A. v. Crédit Lyonnais (Suisse) S.A.* [6], at p. 127). Notwithstanding, I cannot accept Zuz's argument. The subject of the District Court's decision is the application for a stay of proceedings in an action filed by Zuz, on the grounds that there is an arbitration clause. The decision does not deal with a future action of hotels.com against Zuz. All that was held in the decision is that there is no basis for a stay of proceedings with regard to the action of Zuz against hotels.com. Since this is the case, it cannot be said that the arbitration request filed by hotels.com in the United States is tainted by bad faith. Admittedly, within the arbitration request, hotels.com should have mentioned the proceedings that are taking place in Israel and the decision of the lower court. However, I am of the opinion that the failure to mention this fact does not, in and of itself, justify denying the appeal. I will further add that the concern of a split in the litigation between two different tribunals, which has occurred *de facto* in this case, is one of the reasons that led me to the conclusion concerning the proper interpretation of s. 6 of the law and art. 2(3) of the convention (see para. 12 *supra*).

16. Another issue raised by Zuz in the proceeding before us concerns the position of hotels.com with regard to the validity of the agreement. According to Zuz, during the proceeding in the lower court hotels.com tried to advance contradictory arguments: on the one hand, it argued that the

arbitration clause in the agreement should be honoured, and on the other hand it refused to admit entering into the agreement. According to Zuz, in these circumstances we should apply the rule determined in *Mediterranean Shipping Co. S.A. v. Crédit Lyonnais (Suisse) S.A.* [6] and refuse to stay the proceedings. This argument should also be rejected. An inspection of the pleadings filed in the lower court shows that hotels.com did not deny the existence of the agreement, and certainly did not do so expressly. The fact that hotels.com does not deny entering into the agreement is also apparent from the proceeding before us. In any case, the fact that hotels.com itself filed an arbitration request based on the arbitration clause in the agreement shows that it is not seeking to deny entering into this agreement.

17. The result is that the appeal is allowed, and the decision of the District Court, insofar as it concerns the issue of a stay of proceedings, is nullified. The proceedings in Zuz's action against hotels.com are stayed. Consequently, the temporary relief granted by the District Court on 19 September 2004, is set aside. There is no basis for ordering, within this proceeding, a stay of proceedings against Hotels Online, which is not a party to the agreement. Zuz is liable, with regard to both proceedings, for the legal fees of hotels.com in a sum of NIS 60,000 and for court costs.

Vice-President M. Cheshin

I agree.

Justice E. Arbel

I agree with the comprehensive opinion of my colleague Justice A. Grunis and like him I recognize the importance of effective enforcement of international arbitration agreements by adopting uniform and clear rules that will allow the enforcement and implementation of such agreements, including in circumstances where one or more of the litigants is not a party to the arbitration agreement.

Application granted. Appeal allowed.

3 Elul 5765.
7 September 2005.