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Arbitration under the Contracts (Rights of Third Parties) Act 1999 and Enforcement of an Award

by ANDREW TWEEDDALE*

ABSTRACT

The Contracts (Rights of Third Parties) Act 1999 has redressed many of the criticisms made against the English privity of contract rule. Regrettably, however, Parliament ignored the recommendations of the Law Commission and extended the application of the Contracts (Rights of Third Parties) Act 1999 to include arbitration. While this has little impact where a dispute is purely domestic it does have an impact where a dispute has an international character. It may surprise many foreign parties to contracts that are subject to the law of England and Wales that they have, by including reference to English law, potentially given rights to a third party. A third party who has obtained those rights will however find itself having an up-hill struggle to enforce an arbitration award that it might obtain in a foreign jurisdiction. This is because the third party is not a party to the arbitration agreement and the New York Convention applies only to parties to the arbitration agreement. There has not yet been a case on enforcement in a foreign jurisdiction of an award made under the Contracts (Rights of Third Parties) Act 1999 but as the Act is now being used more often this is an issue that may soon have to be addressed by the courts.

I. INTRODUCTION

It is over ten years since the Contracts (Rights of Third Parties) Act 1999 (the 'Rights of Third Parties Act') came into force. The purpose of the Rights of Third Parties Act was to give a third party limited rights under a contract which he was not a party to, if and to the extent that the contracting parties so intended. Where that contract contained an arbitration provision, then the third party could take advantage of that arbitration clause to enforce its rights. Initially, the Rights of Third Parties Act was treated with some scepticism but appears now to be used on many contracts either intentionally or by default. When the Rights of Third Parties

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Act came into force, the Joint Contracts Tribunal ('JCT'), who produces standard form building contracts, introduced amendments to all their 1998 editions of all their Standard Forms of Building Contract by which the parties contracted out of the provisions of the Rights of Third Parties Act. However, in the 2005 editions of the JCT forms, the Rights of Third Parties Act has not been excluded.

The Rights of Third Parties Act was seen as an important change in English jurisprudence as it created a major exception to the privity of contract rule. The privity of contract rule had been subjected to more criticism than any other rule in English law. In summary, the rule was that a contract did not confer rights or impose obligations arising under it on any persons except those parties to the contract. In 1937, the Law Revision Committee had advocated a major statutory reform but the onset of World War II prevented Parliament implementing the changes. Criticisms of the privity of contract rule continued to be made – see *Darlington v. Wiltshier Northern Ltd.*¹ The issue of reform of the privity of contract rule again was considered by the Law Commission in 1996, who issued Report No. 242² and recommended that the privity of contract rule be reformed. The Rights of Third Parties Act was based on the recommendations made by the Law Commission; however, it did not wholly follow all the suggestions of the Law Commission Report. The Law Commission, for example, considered and rejected the idea that arbitration agreements should be included as part of the Rights of Third Parties Act. In its draft Bill, the Law Commission proposed the following:³ 'Section 1 above confers no rights on a third party in the case of . . . an agreement to submit to arbitration present or future disputes.' The reasoning of the Law Commission was that in some cases this would lead to some claims being advanced in arbitration and other claims being advanced in the courts. The Law Commission also saw problems in the appointment of an arbitrator.⁴

Another problem that arises with the Rights of Third Parties Act and arbitration is in relation to enforcement of an award abroad. Neither the Law Commission nor Parliament considered this issue. This problem is considered in this article and, in particular, an award which is to be enforced under the New York Convention. The lacuna in the Rights of Third Parties Act is that the New York Convention applies only where there is '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 . . .'⁵ The right to arbitrate under the Rights of Third Parties Act is a statutory right and does not arise from an agreement between the third party and a party to the contract.

¹ [1995] 1 WLR 68 at 76.

² http://www.lawcom.gov.uk/lc_reports.htm#1996.

³ Section 6(2)(d) of the Draft Bill annexed to the Report.

⁴ See para. 14.17 of Report No. 242.

⁵ New York Convention, Art. II.

II. THE PURPOSE OF THE CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999

The Rights of Third Parties Act provides that a third party (who need not be named or in existence at the time of the contract) is entitled to enforce a term that purports to confer a benefit on him/her.

Andrew Burrows, a former Law Commissioner involved with the drafting of the Rights of Third Parties Act, gave a number of illustrations where he thought that the Rights of Third Parties Act might be used.⁶ It was foreseen that with proper drafting, the Rights of Third Parties Act may be used by a developer to enforce rights against subcontractors so that numerous and complex collateral warranties would no longer be required. It might also be used by subcontractors to take advantage of clauses in a main contract restricting their potential liability for negligence. Again, the subcontractors may be able to rely on a main contract in order to take advantage of indemnity provisions. One can also foresee that there may be situations where a subcontractor claims monies directly from an employer if the employer fails to pay the main contractor for works done by the subcontractor.

Section 1(1)–(6) gives effect to the central purpose of the Rights of Third Parties Act. It states:

- (1) Subject to the provisions of this Act, a person who is not a party to a contract (a ‘third party’) may in his own right enforce a term of the contract if
 - (a) the contract expressly provides that he may, or
 - (b) subject to subsection (2), the term purports to confer a benefit on him.
- (2) Subsection (1)(b) does not apply if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party.
- (3) The third party must be expressly identified in the contract by name, as a member of a class or as answering a particular description but need not be in existence when the contract is entered into.
- (4) This section does not confer a right on a third party to enforce a term of a contract otherwise than subject to and in accordance with any other relevant terms of the contract.
- (5) For the purpose of exercising his right to enforce a term of the contract, there shall be available to the third party any remedy that would have been available to him in an action for breach of contract if he had been a party to the contract (and the rules relating to damages, injunctions, specific performance and other relief shall apply accordingly).

⁶ See SCL paper, Andrew Burrows, *The Contracts (Rights of Third Parties) Act 1999 and Its Implications for Commercial Contracts* Lloyd’s Maritime & Commercial Law Quarterly [2000], p. 540.

- (6) Where a term of a contract excludes or limits liability in relation to any matter references in this Act to the third party, enforcing the term shall be construed as references to his availing himself of the exclusion or limitation.

Sections 2–7 of the Rights of Third Parties Act set out further terms, exceptions and defences that may be available. In particular, these sections provide that the paying party should have protection from double liability.

Section 1(3) above has created a great deal of uncertainty about who will be able to rely on a term within a contract. There will be no doubt about a party where that party is named but there may be doubt when a class of persons is referred to or someone answering a particular description. For example, if the contract expressly provides that a main contractor will provide a specific piece of equipment made only by one manufacturer, then that manufacturer may have rights under the contract. To remove this uncertainty, there are many lawyers who still regularly recommend that the third-party rights, arising under the Rights of Third Parties Act, are excluded from agreements between parties.

III. ARBITRATION AND THE CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999

Section 8 of the Rights of Third Parties Act requires in some cases that the third party proceeds by way of arbitration and permits in other cases a third party to proceed by arbitration. Section 8(1) of the Rights of Third Parties Act states that where a right to enforce a term of a contract under section 1 of the Rights of Third Parties Act is subject to an arbitration provision and that arbitration provision is in writing, then the third party shall be treated for the purposes of the Arbitration Act 1996 as a party to the arbitration agreement ‘as regards disputes between himself and the promisor relating to the enforcement of the substantive term by the third party’.

The logic behind this subsection is straightforward. If a party wants to take the benefit of a right under a contract, then it will be bound by the arbitration clause within the contract. Therefore, if a third party brings court proceedings claiming a benefit under a contract to which the Rights of Third Parties Act applies, the promisor can insist that the litigation be stayed to arbitration. This, however, creates some difficulty where a third party has a variety of claims – some founded in contract and some negligence. Unless section 8(2) of the Rights of Third Parties Act applies, then in this situation the claims that are based on rights arising under section 1 of the Rights of Third Parties Act may have to be dealt with in an arbitration and the other claims in court proceedings.

The wording of section 8(2) of the Rights of Third Parties Act is opaque. Without assistance from the explanatory notes issued with the Rights of Third Parties Act, it would be almost impossible to understand the purpose of the subsection. Section 8(2)(a) states:

(2) Where—

(a) a third party has a right under section 1 to enforce a term providing for one or more descriptions of dispute between the third party and the promisor to be submitted to arbitration ('the arbitration agreement'),

...

the third party shall, if he exercises the right, be treated for the purposes of that Act as a party to the arbitration agreement in relation to the matter with respect to which the right is exercised, and be treated as having been so immediately before the exercise of the right.

The explanatory notes state that this subsection is likely to be of rarer application. It applies, for example, where the contracting parties give the third party a unilateral right to arbitrate or a right to arbitrate a dispute other than one concerning a right conferred on the third party under section (1). There is no case so far reported where section 8(2) of the Rights of Third Parties Act has been used or considered.

IV. JURISDICTION AND THE CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999

Section 10 of the Rights of Third Parties Act states that except for section 9, the remaining provisions of the Rights of Third Parties Act 'extend to England and Wales and Northern Ireland only'. The term 'extends' is interpreted as meaning: 'forms part of the law of', so if the law of England and Wales is the substantive law of the contract, then the Rights of Third Parties Act will apply.

A more difficult question arises where the substantive law of the contract is not the law of England and Wales but the seat of the arbitration is in England. In such circumstances, it is questionable whether the Rights of Third Parties Act applies because only the procedural law of the arbitration is the law of England and Wales. The issue was considered in the recent case of *AES Ust-Kamenogorsk Hydropower Plant LLP v. Ust-Kamenogorsk Hydropower Plant JSC* [2010] EWHC 772.⁷ In this case, the rights under a Concession Agreement were transferred by the Republic of Kazakhstan to the defendant and by the claimant's parent company to the claimant. The Concession Agreement was subject to and governed by Kazakhstan legislation. The Concession Agreement contained an arbitration clause which referred to the ICC Rules and then stated that: 'The arbitration shall be carried out and conducted in London, England...'. The defendant alleged that the claimant was not a party to the arbitration clause. One issue which the English court therefore had to consider was whether the claimant could take advantage of the Rights of Third Parties Act. The claimant argued that 'all and any right' had been transferred to it.

It was accepted by the defendant that there was a good arguable case that under Kazakhstan law, a benefit had been conferred on the claimant. It was also

⁷ The issue of whether the Rights of Third Parties Act applied was not discussed by the Court of Appeal in the subsequent appeal: *AES Ust-Kamenogorsk Hydropower Plant LLP v. Ust-Kamenogorsk Hydropower Plant JSC* [2010] EWCA Civ 647 (May 27, 2011).

conceded that if the claimant did have a benefit conferred by Kazakhstan law, then it was a matter of application of English law as to whether the claimant could enforce that term. The reasoning was that ‘This must be an issue of which substantive English law governs, as being the law of the arbitration clause’.⁸ Both parties’ counsel accepted that under English law, the answer fell to be found in the Rights of Third Parties Act.

The judge concluded that: ‘There is in my judgment no doubt whatever that, at English law, [the claimant], being entitled to the benefit of Clause 32, is entitled to the benefit of, and consequently entitled to enforce, by way of declaratory and injunctive relief, its right to arbitration, pursuant to s1, and, in due course, section 8, of the [Rights of Third Parties] 1999 Act’.⁹

It is not uncommon for international commercial contracts to refer expressly to arbitration in England or to the law of England and Wales. In both cases, there will be the potential for third parties to become involved in dispute resolution proceedings. These contracts may be negotiated by parties who are not English and choose English law or arbitration because it is perceived as being a developed system which is fair. If these parties were told that by choosing the law of England and Wales or arbitration in England they may be granting rights to third parties, then they may reconsider their choice of law. A European Union funded project in Romania, where English law was chosen as the substantive law, had the following particular condition afterwards: ‘the provisions of the Contracts (Rights of Third Parties) Act 1999 shall not apply to this Contract.’ Clearly, the draftsman of this contract foresaw the potential problems that the Rights of Third Parties Act might cause.

V. ENFORCEMENT OF AWARDS AND THE CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999

Where the dispute is domestic in character so that the parties to the contract are English and assets are in England then a third party, who obtains an arbitration award, will be able to enforce it under section 66 of the Arbitration Act 1996. The Rights of Third Parties Act will not create problems with the enforcement of an award because the Rights of Third Parties Act is part of English law.

Where, however, an award is made in England for the benefit of a third party, then problems with enforcement may occur if the third party needs to enforce that award in another country that does not recognize third-party rights. The starting point for enforcement of many international arbitration awards is the New York Convention. In order to enforce an award under the New York Convention, a party is required to supply:¹⁰

⁸ *AES Ust-Kamenogorsk Hydropower Plant LLP v. Ust-Kamenogorsk Hydropower Plant JSC* [2010] EWHC 772 para. 29.

⁹ *Ibid.*, para. 32.

¹⁰ Art. IV of the New York Convention.

- (a) the duly authenticated original award or a duly certified copy thereof;
- (b) the original agreement referred to in article II or a duly certified copy thereof.

The original agreement as referred to in Article II of the Convention is defined as follows:

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.

The initial problem that a third party will face is that it will not be a party to the arbitration agreement nor will the third party have signed the contract between the parties in which the arbitration agreement is contained. The right of the third party to bring the arbitration proceedings under the Rights of Third Parties Act is statutory and does not arise out of a contract between the parties. In a number of cases, courts around the world have stated that there is a requirement that there be some record to evidence the agreement of the parties to resolve the dispute by arbitration.¹¹ In the case of *Eddie Javor v. Francour and Fusion Crete Inc.*,¹² the Supreme Court of British Columbia had to address the issue of whether a person who is not a signatory to an arbitration agreement but had been found by the arbitrator to be a proper party could have an award against him enforced. The Supreme Court reached the following conclusions:

- that the New York Convention does not apply to 'non-parties' to the arbitration agreement;
- that the procedure that was followed was not in accordance with the agreement of the parties because Francoeur was never a party to the arbitration agreement; and
- the recognition of the award would be contrary to public policy.

The decision of the Supreme Court has been criticised. One law firm has stated that:¹³ 'Someone who is found to be a proper party to an arbitration is bound by the commitment to arbitrate, whether as a signatory or as a matter of law'. In the case of *Investor (Germany) v. Republic of Poland*,¹⁴ the Supreme Court of Germany also concluded that it was not necessary in every case for the party to produce a copy

¹¹ See *Leon Schellenberg v. Sheldon Proctor* [2002] MBCA 170.

¹² 2003 BCSC 350; 13 BCLR (4th) 195.

¹³ Ogilvy Renault, *New York Convention of 1958 & UNCITRAL Model Law on International Commercial Arbitration*, published on their website: www.ogilvyrenault.com at page 8.

¹⁴ 21 Praxis des Internationalen Privat- und Verfahrensrechts (IPRax) (2001, No 5) 458-9 with note C Krapfl, 44305 (2001) XXVI Ybk Comm Arb'n 771, Aug. 17, 2000, Bundesgerichtshof (Supreme Court).

of the original arbitration agreement. In that case, the right to arbitrate arose under a Treaty. The Supreme Court stated that Article IV of the New York Convention was an evidential provision. However, the contrary view has been expressed by a number of other municipal courts.

In *Satico Shipping Co. Ltd v. Maderas Iglesias* (2007),¹⁵ the Supreme Court of Spain refused to enforce an arbitration award where the contract had been made between brokers for the parties and the charter party agreement had not been signed by either party.¹⁶ Similarly, in *Moscow Dynamo (Russian Federation) v. Alexander Ovechkin* (2006),¹⁷ the United States District Court of Columbia concluded it did not have jurisdiction to enforce an award. The court held that: 'Without an agreement in writing that satisfies this provision, [Art. II of the New York Convention] there is no subject matter jurisdiction.' The court then referred to the case of *Czarina LLC v. W.F. Poe Syndicate*, 358 F.3d 1286, 1291 (11th Cir. 2004) to support this conclusion. The court stated that: 'The principle of arbitration exists because arbitration is a creature of contract, and thus the powers of an arbitrator extend only as far as the parties have agreed they will extend'. The court finally held that there is: 'no legal authority to support its argument that a written agreement to arbitrate can be found absent a written exchange demonstrating both parties' agreement to arbitrate with one another. The Court is not persuaded to imply Ovechkin's written consent to arbitrate when he never communicated with Dynamo, let alone negotiated an arbitration clause with a third party...'

The alternative to enforcement under the New York Convention, for a party who has an award made in England, is to have the award converted into an English court judgment and then to enforce the judgment rather than the award. However, this route is fraught with difficulties especially if the enforcing court would not recognize the award itself.¹⁸ Enforcement of a court judgment has, however, been successful in other cases even if the award would not have been enforced.¹⁹

¹⁵ Yearbook Comm Arb'n XXXII (2007) 582.

¹⁶ A similar conclusion was reached in *Vicere Livio v Prodexport* 31 Giustizia civile (1981) I cols. 1910–1912.

¹⁷ Yearbook Comm Arb'n XXXI (2006) 1396.

¹⁸ *Fratelli Damiano snc v. August Topfer & Co.*, Yearbook Comm Arb'n XVII (1992) 559–61.

¹⁹ *Ocean Warehouse BV v. Baron Metals and Alloys Inc. and Marco International* (2001) UD Disrt LEXIS 6898; and *Island Territory of Curacao* 489 F. 2d. 1318.

VI. CONCLUSION

The criticisms of the privity of contract rule were well founded and its demise was long overdue. Regrettably, however, Parliament ignored the recommendations of the Law Commission and extended the application of the Rights of Third Parties Act to include arbitration. While this has little impact where a dispute is purely domestic, it does have an impact where a dispute has an international character. It may surprise many foreign parties to contracts that are subject to the law of England and Wales that they have, by including reference to English law, potentially given rights to a third party. The third parties who have obtained those rights will, however, find themselves having an up-hill struggle to enforce any award that they might obtain.

