Multiparty Controversies in International Construction Arbitrations

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I. Introduction

This article treats a facet of international commercial arbitration that almost always presents difficulties to the practitioner, both during the negotiation of the underlying contract and in subsequent dispute proceedings, that of controversies involving more than two parties. The peculiar "man-in-the-middle" problem such controversies often present, especially in connection with international construction projects, will first be described; the alternatives currently available in arbitration for dealing with that problem will then be examined; and finally a proposal for improvement will be suggested.

II. The Commercial Context

Multiparty controversies can arise in a variety of contexts: in sales contracts—for example, when a seller's supplier declares force majeure, and the seller fails to deliver to its buyer; in licensing contracts—when a licensor defines the scope of separate licenses for the same technology in common terms, and licensees take conflicting actions based on different interpretations of those terms; and in investment contracts—as illustrated in the example given by Georges Delaume earlier in the program. The most acute difficulties, however, are probably presented in connection with construction projects.[1]

In a single international project to design and construct plant processing facilities, for example, the prime contractor, say a U.S.-based company, will have contract relations with a host of other parties:

- With the project owner, of course, commonly a governmental agency of a Third World country involved in extensive industrial development, to whom the prime may have complete responsibility for construction and possibly all or part of the design responsibility as well.
- Often with specialty firms, such as a French or British firm of soils mechanics, whose expertise is used to help establish basic design parameters.

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[1] *See* G. Bernini, *Arbitration in Multi-Party Business Disputes*, V Y.B. COM. ARB. 291, 291-92 (1980) (making similar observations).

- With a variety of subcontractors, from Europe, Asia or the Middle East, who will perform portions of the assigned design and construction work for which they have a noted technical capability or cost advantage.
- And with material suppliers from all parts of the globe.

Frequently, disputes that arise during the project will involve the prime contractor and two or more of these parties. The owner may allege that a part of the facilities designed and constructed by one of the subcontractors is defective. The prime contractor will, of course, look to the concerned subcontractor. That subcontractor may, in turn, reply that the defect arose because of improper operation of the facilities by the owner, poor workmanship in related portions of the facilities by another subcontractor, or inaccurate information furnished by the soils specialist.

A similar situation can exist for the prime contractor when a subcontractor is the claimant in the first instance. The subcontractor may allege that an owner-originated direction resulted in extra work, or that actions by the owner or another subcontractor delayed the progress of its own work.

The special risk presented by all of these cases is that of the prime contractor getting caught in the middle because different decisionmakers render inconsistent findings of fact or inconsistent interpretations of similar contract provisions. To use the defect example again:

- The decisionmaker in an owner-prime proceeding may conclude that a portion of the facilities are inherently defective because of the design adopted by the concerned subcontractor.
- A second decisionmaker in a prime-subcontractor proceeding may conclude that a defect exists, but that it was caused by another subcontractor's poor workmanship in related work.
- A third decisionmaker in a prime-other subcontractor proceeding may conclude that there is no defect at all, and that the poor performance of the facilities resulted from improper operation by the owner.

In the illustration given so far, the prime contractor had the man-in-the-middle problem. The prime had the problem in those situations because in the absence of special limiting provisions in its contract, the owner is not concerned whether a defect resulted from inadequacies in the prime's performance or in the performance of one of the subcontractors, since the prime is responsible to the owner in contract for both. Similarly, in the absence of special limiting provisions, the subcontractor is not concerned whether the owner, the prime contractor or another subcontractor caused additional work or delay, because the subcontractor's scope of work and schedule premises are defined in its own contract with the prime.

However, the owner or the subcontractor may be the one standing in the middle just as often as the prime: the subcontractor, because it is in the same position between the prime and its own sub-subcontractors as the prime is between the owner and the subcontractor; and the owner, because it may have split the design and construction of the facilities among a

number of different contractors or may have itself contracted with speciality firms to furnish preliminary information, and so may stand between the prime and any of those parties.

Although owners have historically favored a single "turnkey" project contract, they are turning to multiple design and construction contracts with increasing frequency, particularly in large-scale endeavors. Generally, dividing a large project into a series of discrete design and/or construction packages results in more bidding competition and an earlier overall start and completion of construction.

III. Existing Alternatives in International Arbitration

The man-in-the-middle problem can usually be adequately dealt with in judicial proceedings, particularly proceedings conducted in the United States.[2] There are liberal joinder and consolidation provisions contained in the Federal Rules of Civil Procedure and many state procedural codes.[3]

While, as I'm sure we've all learned to our chagrin at one time or another, these provisions, either by their terms or as applied by the courts, do not comprehend every man-in-the-middle situation, they do encompass the great majority of cases. Equally satisfactory mechanisms are not, however, generally available in international commercial arbitration.

In theory there are at least four methods by which a party could protect itself against the problem: (1) by negotiating arbitration clauses authorizing consolidation in each of the relevant contracts; (2) by entering into a submission agreement providing for consolidation with the concerned parties; (3) by application for arbitral consolidation to a national court; or (4) by operation of the rules of an international arbitration association.[4]

But in practice each of these alternatives has major shortcomings; and, except as to the last one, it is doubtful that the shortcomings can be eliminated or sufficiently mitigated so that any one of them could be judged a generally acceptable and available solution.

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[2]The same is true in many other countries. *See, e.g.*, C. PR. CIV., art. 101, 331 & 367 (F. Grivart de Kerstrat & W. Crawford trans. 1978) (French joinder and consolidation provisions).

[3]FED. R. CIV. P. 14(a), for example, provides that a defendant may complain against any third-party "who is or may be liable to him for all or part of the plaintiff's claim against him"; and Rule 42(a) provides that "when [several] actions involving a common question of law or fact are pending before the court, it may order a joint hearing or trial of any or all the matters in issue . . . [or] may order the actions consolidated." *See also e.g.*, CAL. CIV. PROC. CODE § 428.10(b) (West 1973); CAL. CIV. PROC. § 1048(a) (West 1980) (comparable California provisions).

[4]The option of consolidation in a single judicial proceeding is usually not available as long as there is at least one party who desires to enforce a contract arbitration clause. Under the New York Convention national courts in signatory countries are required to order arbitration upon request. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, *opened for signature* June 10, 1958, art. II, § 3, 21 U.S.T. 2517, T.I.A.S. No. 6997, *reprinted following* 9 U.S.C.A. § 201 (West Supp. 1982); *see, e.g.*, McCreary Tire & Rubber Company v. CEAT S.p.A., 501 F.2d 1032, 1036-37 (3d Cir. 1974).

A. *Arbitration Clauses*

Arbitration is a creature of contract, and a form of arbitration clause authorizing consolidated proceedings could be included in all the relevant contracts and would likely be considered valid and enforceable.[5] Consolidation is a matter of arbitral procedure, and many national laws of arbitration[6] and the rules of many international arbitration institutions[7] permit parties great freedom in establishing rules of procedure.

However, getting all the interested parties to agree upon arbitration clauses with a consolidation provision is extremely difficult. The problems of draftsmanship alone are considerable. At a recent conference on multiparty disputes, for example, no participant was willing to even venture a proposal.[8]

Also, there seems to be a firmly established usage of international trade, at least in the construction sector, that no matter how complex the technology or financing involved, and no matter how many months or even years are devoted to the drafting of the contract, no more than fifteen minutes can ever be allocated to the negotiation of an arbitration clause, with fourteen of the fifteen minutes reserved for debate on whether or not to have such a clause at all.

I'm afraid that we lawyers will never enjoy more than passing success in convincing our clients that the content of arbitration clauses can be as important as the content of payment or scope-of-work clauses. Obtaining a common basis for arbitration in a multicontract situation, such as by reference to the rules of the same arbitration institution, is probably the most that can be realistically achieved in the majority of cases. The esoterics of arbitral procedure will never command broad attention during the negotiation process.

B. *Submission Agreements*

If negotiation of clauses authorizing consolidation is extremely difficult before disputes have arisen, it is virtually impossible after the fact, because

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[5] As to the interpretation and enforceability of consolidation clauses by United States courts, *cf.* Gavlik Construction Company v. H.F. Campbell Company, 526 F.2d 777, 787-89 (3d Cir. 1976); Uniroyal, Inc. v. A. Epstein and Sons, Inc., 428 F.2d 523, 525-28 (7th Cir. 1970) (both cases dealing with contract provisions that authorized consolidation only by implication).

[6] *See, e.g.*, INTERNATIONAL CHAMBER OF COMMERCE, ARBITRATION LAW IN EUROPE (1981): Austrian law at 18-19; Swiss law at 52-55 & 62; French law (Supp. to p. 149); law of England and Wales at 166; Swedish law at 332; *see generally* I-VII Y.B. COM. ARB. Parts I (1976-82) (Part I of each volume contains reports on national arbitration laws—53 to date.).

[7] *See, e.g.*, INTERNATIONAL CHAMBER OF COMMERCE, RULES OF THE COURT OF ARBITRATION [hereinafter cited as ICC RULES], art. 11 (Arbitration) (1975); LONDON COURT OF ARBITRATION, INTERNATIONAL ARBITRATION RULES [hereinafter cited as LONDON RULES], Rule 5 & Schedule of Jurisdiction and Powers of the Arbitrator at ¶ C(1) (1981); Rules of the Arbitration Institute of The Stockholm Chamber of Commerce, Rule 15 (1976).

[8] INSTITUTE OF INTERNATIONAL BUSINESS LAW AND PRACTICE, MULTIPARTY BUSINESS DISPUTES 14 & 63 (1980); *see* G. Bernini, *supra* note 1 at 299; E. Singleton, *The Resolution of Multiparty Disputes*, in MULTIPARTY BUSINESS DISPUTES 45, 52-53 (1980).

one or more of the interested parties will enjoy tactical advantages from the status quo that it does not want to surrender.

The claimant, for example, will normally have the prospect of earlier payment without consolidation, because it need only prove the liability of its immediate contractual partner and this can be achieved more quickly in a single two-party proceeding. A secondary defendant, who fears it may ultimately be found liable, may believe that the parties standing between it and the claimant will be induced to contribute more to any settlement if they continue to be exposed to the possibility of inconsistent findings by different arbitrators. Considerations of overall litigation economy, substantive justice and procedural fairness simply have little persuasive force in specific adversarial situations.

C. *National Arbitration Laws*

Since the two direct methods of achieving consolidation are not satisfactory, the next alternative to spring to any attorney's mind is "to go to court." But "going to court" does not always work, even assuming all of the relevant contracts call for arbitration at the same situs.

Apparently, the United States is the only country whose law clearly permits the consolidation of arbitration proceedings in the absence of specific party agreement. The Federal Arbitration Act[9] applies to international arbitrations conducted in the United States,[10] and Federal Rule of Civil Procedure 81(a)(3) makes Rule 42(a), authorizing the courts to order consolidation, applicable to proceedings under that act.[11]

Unfortunately, the United States is not often selected as the situs of international construction arbitrations. To begin with, it is usually not very convenient. Typically, the project and most of the parties are half a world away. Further, parties to international contracts are normally reluctant to accept another's home country as an arbitration situs and will suggest that a neutral location, commonly in Europe, be selected instead.

The law applicable in the leading European arbitration centers is either adverse, silent or unsettled on the question of mandatory consolidation. For example, under both French and Swiss law, the courts in those countries have no power to order consolidated arbitration proceedings in the absence of party agreement, specifically expressed in either the relevant

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[9] 9 U.S.C. §§ 1-14 (1976).

[10] *See* 9 U.S.C. §§ 1-5 and 9-11 (1976).

[11] *See, e.g.*, Compania Espanola de Petroleos, S.A. v. Nereus Shipping, S.A., 527 F.2d 966, 974-76 (2d Cir. 1975), *cert. denied*, 426 U.S. 936 (1976); Marine Trading Ltd. v. Ore International Corp., 432 F. Supp. 683, 684-85 (S.D.N.Y. 1977); Robinson v. Warner, 370 F. Supp. 828, 829-31 (D.R.I. 1974).

See also CAL. CIV. PROC. CODE § 1281.3 (West 1982) (California provisions authorizing the mandatory consolidation of arbitration proceedings).

contract arbitration clauses or in a submission agreement.[12] Swedish, German and Italian law are all similar or at least silent.[13]

The law of England and Wales is unsettled, although there is cause for optimism in a recent court of appeal decision by Lord Denning. The case is discussed in detail in the handout that will be available at the conclusion of this afternoon's activities.[14] In brief, the court of appeal held that although it did not have power to order consolidation in the absence of specific party consent, it did have power to appoint the same arbitrator in two related construction arbitrations. Further, the court suggested that the single appointed arbitrator was free to adopt and, as a matter of policy, should adopt a procedure whereby those issues common to both proceedings would effectively be decided together.[15]

Although many times London will be a neutral arbitration situs acceptable to the parties to an international construction project, this, of course, will not always be the case. Moreover, there are some disadvantages to arbitrating in London that in particular circumstances may outweigh the potential to achieve consolidation. Thus, at best national arbitration laws offer potential solutions to the man-in-the-middle problem in only a limited number of cases.

D. *Institutional Rules*

More often than not arbitration clauses in international contracts will provide that the proceedings are to be conducted under the auspices of one of the major international arbitration institutions.

The leading such institution is the Court of Arbitration of the International Chamber of Commerce, whose administrative office is located in Paris. The ICC has averaged about 250 new case filings per year over the last several years, with an average amount in controversy of over $1,000,000 U.S. About 30 percent of the disputes submitted to the ICC arise out of construction projects.[16]

But, with one exception,[17] neither the ICC Rules[18] nor the rules of most

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[12]Advice of Maitre Fernand C. Jeantet, Paris (French law), and Maitre Robert Briner, Lenz, Schluep, Briner & De Coulon, Geneva (Swiss law); *accord* Concordat Suisse sur l'Arbitrage, art. 28 (Editions Payot trans. 1974) (Swiss arbitration law applicable in most cantons).

[13]Advice of Stockholm Chamber of Commerce (Swedish Law), Dr. Horst Bruecher, Mueller Weitzel Weisner, Frankfurt (German law), and Avv. Giovanni DeBerti, DeBerti & Jacchia, Milan (Italian law); *see* Lag om skiljeman 1929 No. 145 (as amended) (trans. in 2 *International Commercial Arbitration*, Doc. VII.C.1 (C. Schmitthoff ed. 1979)) (Swedish arbitration law).

[14]Appendix A.

[15]My thanks to David R. Wightman of Kenneth Brown Baker Baker, London, for his comments on this case.

[16]Y. Derains, *New Trends in the Practical Application of the ICC Rules of Arbitration*, 3 NW. J. INT'L L. & POL'Y 39, 39 nn. 1, 2 & 4 (1981).

[17]London Rules, Rule 5(1) & Schedule of Jurisdiction and Powers of the Arbitrator at ¶ C(1), discussed *infra*.

[18]In 1980 the ICC did adopt an internal rule authorizing the joinder of additional claims in a pending proceeding if the claims arise between the same parties and out of the same legal

of the other major international arbitration institutions[19] address the question of consolidation.[20] Apparently, those institutions are concerned that a consolidation rule would be viewed as an infringement on party autonomy, to which they are especially sensitive as organizations without sovereign regulatory authority. Also, there may be a fear that a consolidation rule would undermine the traditional appointment procedure, whereby each of the parties nominates one arbitrator on a three-person panel.[21]

IV. A Proposal

It is submitted that these objections do not justify declining to enact at least a limited consolidation rule. A form of proposed rule is contained in the handout you will receive,[22] and I urge the major international arbitration institutions to consider its adoption, with such modifications as may be appropriate.

The proposed rule has these main features:

1. The rule limits consolidation to instances involving a single international construction project, authorizes the consolidation of just two separate arbitration proceedings and then only when there is a party common to both proceedings.
2. The power of the parties by specific provision to vary the terms of the rule or to "opt-out" of the rule altogether is expressly recognized.
3. The issues to be heard and decided on a consolidated basis are specified by the arbitrators in the two pending arbitrations, including any party-nominated arbitrators, after the parties have had an opportunity to be heard.
4. The issues specified for consolidation are heard and decided by arbitrators designated by the chosen arbitral institution, from among those already appointed and, in certain cases, an additional arbitrator.

The construction limitation is included because the man-in-the-middle problem is encountered most frequently in that context; and because the problem affects owners as well as engineers and contractors, so that an ameliorating measure should enjoy widespread support and not be viewed as a product of parochial interests.

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relationship. The joinder may be ordered even if the party making the additional claims desires a separate arbitration. ICC Rules, art. 18 (App. II, Internal Rules of the Court of Arbitration). An earlier-adopted rule authorizes the joinder of additional claims upon request of the party claiming. ICC Rules, art. 16 (Arbitration).

[19]*E.g.*, American Arbitration Association, Arbitration Institute of The Stockholm Chamber of Commerce, Zurich Chamber of Commerce.

[20]Nor do the UNCITRAL Rules. *See* United Nations Commission on International Trade Law, Arbitration Rules (1976).

[21]My thanks to W. Laurence Craig of Coudert Freres, Paris, for his comments on this subject.

[22]Appendix B.

The limitation to the three-party situation is included for reasons of practicality. Permitting the joinder of even just a third party will, it is thought, substantially mitigate the man-in-the-middle problem, while allowing consolidated proceedings between four, five or six parties might well entail unacceptable delay.

The provisions relating to the specification, hearing and decision of the consolidated issues are designed to maximize the participation of both the parties and the arbitrators already appointed, consistent with fairness accepted perceptions of impartiality and the need to avoid deadlocks.

The power to vary the rule or opt-out altogether is made express to emphasize the parties' autonomy. In this connection it should be observed that most institutional rules of arbitral procedure are of an"opt-out" nature: that is, the parties do not have the burden of specifically calling for their operation but rather the burden of disclaiming them.

Since they operate without specific party consent, such rules can, in one sense, be viewed as infringements on party autonomy. But this burden-shifting aspect is one of the major attractions of institutional arbitration in the first place, because parties are thereby relieved from formulating and agreeing upon ad hoc rules in every contract negotiation. Consequently, the test as to whether any particular institutional rule, such as a consolidation rule, should be of an opt-out rather than an opt-in nature should be its acceptability on a general basis, and not abstract notions of party autonomy.

Moreover, there already are a number of institutional rules of an opt-out nature that affect significant party rights. For example, the ICC Rules provide that by submitting to arbitration, the parties are deemed "to have waived their right to any form of appeal."[23] The ICC Rules also provide for the mandatory joinder of claims between the same parties in certain circumstances.[24] And provisions of the London Court of Arbitration Rules[25] come very close to establishing a full opt-out rule of consolidation.

Under the London Rules arbitrators are empowered to order additional parties to be joined in a pending arbitration unless all the existing parties "at any time agree otherwise." The drawback is that the joinder can be effected only with the "express consent" of the parties joined, and the "express consent" must be specifically to joinder rather than generally to arbitration.[26]

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[23]ICC Rules, art. 24, § 2 (Arbitration).

[24]ICC Rules, art. 18 (App. II, Internal rules of the Court of Arbitration); *see supra* note 17 at 15.

[25]London Rules, Rule 5(1) & Schedule of Jurisdiction and Powers of the Arbitrator at ¶ C(1).

[26]Advice of the Deputy Registrar, London Court of Arbitration.

V. Summary

In summary, the present methods for dealing with multiparty controversies in international arbitration are unsatisfactory. The most practical solution to the problems presented is for the major arbitration institutions to adopt rules authorizing forms of consolidation in appropriate contexts. The construction sector is an appropriate beginning context, and workable and generally acceptable rules can be devised.

APPENDIX A

Abu Dhabi Gas Liquefaction Co., Ltd. v. Eastern Bechtel Corporation; Eastern Bechtel Corporation v. Ishikawajima-Harima Heavy Industries Co., Ltd., 1981 A. No. 4268, judgment transcript (C.A. June 23, 1982).

This was a consolidated appeal from decisions appointing sole arbitrators in two separate proceedings under the (English) Arbitration Act 1950. One arbitration was initiated by Abu Dhabi Gas Liquefaction Company Limited (ADGLC), the owner of complex gas liquefaction facilities on Das Island in the Arabian Gulf, against Eastern Bechtel Corporation and Chiyoda Chemical Engineering and Construction Co., Ltd. (B/C), a joint venture that was the prime contractor for the design and construction of the facilities. ADGLC alleged that two large liquefied natural gas storage tanks designed and constructed by one of B/C's subcontractors, Ishikawajima-Harima Heavy Industries Co., Ltd. (IHI), were defective. The second arbitration was initiated by B/C against IHI.

B/C had required the High Court to appoint the same arbitrator in both proceedings in order to avoid the possibility of inconsistent findings of fact, particularly as to the cause of the admitted cracking of one of the two tanks.

The High Court judge (Mr. Justice Bingham) held that because he lacked authority to order consolidated proceedings or to appoint an arbitrator subject to conditions (e.g., that the arbitrator order consolidated proceedings), two different arbitrators should be appointed. The judge reasoned that if a single arbitrator were appointed, he might be prejudicially inclined to adhere to a finding made in the first arbitration on an issue common to both proceedings, despite what different evidence or arguments might be submitted on that same issue in the second arbitration.

The court of appeal agreed that courts have no power to order consolidation or to impose conditions upon an appointed arbitrator. The court held, however, that it did have power under section 10 of the Arbitration Act 1950 to appoint the same arbitrator in separate arbitrations,[27] and that it was highly desirable to do so in these cases in order to avoid the possibility of inconsistent findings of fact.

In dicta Lord Denning made several suggestions on how the single appointed arbitrator should proceed: (1) the arbitrator should hold a pre-trial conference among all three interested parties to segregate the common issues; (2) the issues pertinent only to the first (owner-prime) arbitration should then be tried, with recourse to the courts on point of law if necessary; (3) the common issues should be tried next, apparently with separate hearings but with both sets of hearings taking place before a decision was rendered in either case; and (4) if either the arbitrator or the parties considered that the arbitrator would be prejudiced in hearing the common issues after having decided the owner-prime issues, a different arbitrator might be appointed to hear and decide the common issues as well as any remaining issues.

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[27]Section 10 of the Arbitration Act 1950 generally authorizes the High Court to appoint arbitrators. The section does not expressly address the question of appointing the same arbitrator in related proceedings.

Lord Justices Watkins and Fox agreed with Lord Denning's suggestions, but Lord Justice Watkins did emphasize that a large degree of flexibility should be allowed to the arbitrator by the parties or insisted upon by the arbitrator. Lord Justices Watkins and Fox also stated that prejudice as a result of the prior determination of the owner-prime issues was unlikely in view of the caliber of the arbitrator appointed (Sir John Megaw).

There were two major questions left open by the decision: (1) whether the arbitrator has power to order joint hearings on the common issues in the absence of party agreement; and (2) in what circumstances, if any, the arbitrator should or must disqualify himself from hearing and deciding the common issues following his disposition of the separate owner-prime issues.

APPENDIX B

PROPOSED RULE

1. The arbitrators in two separate proceedings under these Rules may determine to hear and decide issues common to both proceedings on a consolidated basis, provided that: (a) the parties to either proceeding have not precluded the arbitrators from doing so in their agreement to arbitrate;[28] (b) one of the parties is a party to both proceedings; (c) both proceedings involve disputes arising out of or connected with the same construction project; and (d) the parties in both proceedings have had an opportunity to be heard on the question of consolidation.

2. Upon the arbitrator in each proceeding so determining, consolidated hearings shall take place on those issues that both arbitrators have specified as common, at times and places fixed by the arbitrators.

3. If a sole arbitrator has been appointed in each proceeding, unless the same person has been appointed, a third arbitrator shall be appointed by the court[29] and the three arbitrators shall hear and decide the common issues.

4. If three arbitrators have been appointed in each proceeding, none of whom has been nominated by the parties, the common issues shall be heard and decided by arbitrators designated by the court from among those already appointed, three in number if at least two of the arbitrators in each proceeding are the same, otherwise five.

5. If three arbitrators have been appointed in each proceeding, two of whom have been nominated by the parties, the common issues shall be heard and decided by the two arbitrators not nominated by the parties and a third arbitrator appointed by the court.

6. If the composition of the appointed arbitrator tribunals does not fall within sections 3-5, there shall be no consolidation in the absence of common specific directions in the two agreements to arbitrate.

7. The decision on the common issues shall be by majority and shall be made a part of the award in each proceeding.

8. Parties are free to vary the provisions of this article by agreement.

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[28]The term "agreement to arbitrate" includes both a contract arbitration clause and a subsequent party stipulation.

[29]Refers to an internal body, *e.g.*, Court of Arbitration of the International Chamber of Commerce.