ARBITRAL AWARDS
RENDERED IN 2000 IN SCC CASE 34/99

OBSERVATIONS BY CHRISTOPHE IMHOOS

A. The agreements and the parties

An "Equipment Contract" was entered into between a Chinese buyer, Claimant No. 3 in the arbitration, and a Canadian seller, R, the Respondent in the proceedings, for the delivery of a food freeze drying system consisting of a number of components among which two freeze dryers, manufactured by Company H located in the U.S.A. The parties also simultaneously signed a "Service Contract".

Claimant No. 3 was acting as agent for the Chinese importer, Claimant No. 1 in the arbitration, which had also signed the contract. By amendment of later date, another Chinese company, Claimant No. 2 in this arbitration, was added as the Importer's agent and a party to the Equipment Contract.

The Equipment Contract contained an arbitration clause providing for arbitration in Stockholm under the rules of the Arbitration Institute of the Stockholm Chamber of Commerce.

B. The dispute

The delivery of the freeze dryers to Claimant No. 1 was delayed. After delivery, Claimant No. 1 complained of damages and deficiencies in the equipment.

Thereafter, the Claimants in this arbitration, as "The China Party" on one side, entered into a "Modified Agreement" with Respondent and H, as "The Foreign Party" on the other side. This agreement provided that R, the seller of the equipment, and H, the manufacturer, would undertake all costs associated with certain replacements and repairs of the equipment which would be tested and accepted by Claimant No. 1 on the basis of specified performance criteria to be completed within a certain time-limit. At the end of the contract was stated : "All the rights stated in the original contract remain for all parties".

The modification work was not timely completed and the date for final acceptance was therefore postponed which resulted in Claimants' having rejected the entire equipment which was finally never accepted by the buyer. Thereafter, R declared the contract void.

C. The proceedings

The Chinese buyer and its agent, Claimant Nos. 1 and 3, initially filed a request for arbitration against the Canadian seller. The relief claimed included a declaration that the Equipment

Contract and the Service Contract were void, refund of the prices paid with interest thereon, penalty for late delivery and damages for losses suffered by the Importer, Claimant No. 1.

The seller denied that Claimants were entitled to any of the relief sought, having itself raised set-off and counterclaims. It preliminary submitted that it was beyond the Arbitral Tribunal's jurisdiction to deal with issues resolved through the Modified Agreement and that the scope of the arbitration was therefore limited to Claimants' claims arising from alleged late delivery.

At the request of Claimants No. 1 and 3, the Arbitral Tribunal, after having received the consent of Respondent, decided to accept Claimant No. 2 as a party to the arbitration with the same position as that of the original claimants.

In its reply to the request for arbitration, R expressed the opinion that H, the U.S. Manufacturer, should be included as a party to the arbitration. It later brought an application for a preliminary ruling that H was a necessary and proper party and that the arbitration could not or should not proceed without H.

On the substance, Claimants declared that the Respondent's failure to deliver the equipment in compliance with the specifications and warranty of the Equipment Contract and its failure to repair the equipment within the grace period granted in the Modified Agreement constituted a fundamental breach of contract.

D. The Arbitral Tribunal's decisions

1. On the preliminary ruling

Respondent contended that H was a necessary party to the arbitration which could not proceed without H. Claimants objected to such an allegation on the ground, in the first place, that H was not a party to the arbitration agreement contained in the Equipment Contract; should H be bound by the said arbitration agreement, Claimants submitted further that they were entitled to choose which party to lodge theirs claims against.

The Arbitral Tribunal examined whether a valid arbitration agreement had ever existed between Claimants and H. The majority of the Arbitral Tribunal found that H had neither been mentioned as a party nor signed the Equipment Contract and that it failed to see any other elements that would have evidenced the endorsement by H of the arbitration clause that was part of said contract.

The majority of the Tribunal, then, examined the Modified Agreement that had been signed by H and all other parties involved in the dispute to ascertain whether, at that stage, H had became a party to the arbitration agreement included in the Equipment Contract; Claimants denied that this had been the intent of the parties.

Considering that the Modified Agreement contained no arbitration clause nor explicit reference to the arbitration clause in the Equipment Contract and considering also the mere reference in the Modified Agreement to the Equipment Contract which could not be construed as an agreement of such purport, the majority of the Arbitral Tribunal found that Respondent did not succeed in proving that the parties to the Modified Agreement had been in accord that H should be bound by the arbitration clause in the Equipment Contract or by any other

arbitration agreement in relation to the Claimants. The majority concluded therefore that there was not sufficient ground to establish the existence of a valid arbitration agreement between the Claimants and H.

Lastly, the Arbitral Tribunal examined Respondent alternate submission that, in case H was not bound by the arbitration clause, such a clause does not at all apply to claims arising out of or in connection with the Modified Agreement and the arbitration with regards to these claims should be dismissed.

Considering that the relation between the two agreements and the possible consequences of the fact that the parties were not identical was a matter which concerned the substance of the dispute and considering also that nothing in the Modified Agreement could be construed as a deviation from the arbitration clause in the Equipment Contract which covered all disputes arising "in connection with" the Contract, the majority of the Tribunal rejected the Respondent's motion for the dismissal of the arbitration. The arbitration proceeded therefore between the Claimants and Respondent.

2. <u>The dissenting opinion</u>

The arbitrator appointed by Respondent expressed the diverging view that the Tribunal should have required oral evidence to assess fairly the relationships between the Equipment Contract and the Modified Contract.

For the dissenting arbitrator, there were sufficient grounds to establish a valid arbitration agreement between the Claimants and H; the clause contained in the Modified Contract stating that "All the rights stated in the original contract remain for all parties" surely included the arbitration provision.

The dissenting arbitrator finally pointed out that no compelling authority supported the Claimants' contention that even if the Modified Contract contained an arbitration clause they were entitled to proceed against Respondent only.

3. <u>On the merits</u>

The Arbitral Tribunal preliminary decided that Respondent was precluded from claiming at that stage of the proceedings that the scope of the arbitration was limited to claims arising from the alleged late delivery of the equipment as it had already decided in a separate award that it saw no reason for dismissing any of the Claimants' claims on the sole ground that they fell outside the scope of the arbitration agreement in the Equipment Contract.

After having concluded that the Modified Agreement had set a definite time-limit for the acceptance of the freeze dryers after successful performance tests and found that Respondent did not comply with the provision in the Modified Agreement concerning the time when the equipment would be ready for final acceptance, the Arbitral Tribunal decided that Respondent's failure to fulfil its obligations amounted to a breach of contract which entitled the Claimants to resort to the remedies prescribed in the Equipment Contract, namely the use of their right to terminate the contract. However, the Tribunal considered that the termination of contract applied to the freeze dryers but not as to the other parts of the system.

The Arbitral Tribunal then came to the conclusion that Claimant No. 1 was entitled to refund of the purchase price for the freeze dryers against the return of the equipment. In addition, it found that the Respondent's failure to fulfil its obligations under the Contract with the freeze dryers gave the Claimants a right to claims damages but, in the Arbitrators' view, limited to those costs which were directly related to the various equipment items and which would have no remaining value for Claimant No. 1 if the equipment was to be returned to the seller

The Arbitral Tribunal had also found that the Respondent's late delivery of the freeze dryers entitled the Claimants to a maximum penalty pursuant to the Equipment Contract.

E. Comments

The two arbitral decisions rendered in this matter addressed various interesting legal issues, both as regards the procedure and the merits; the introduction of an additional respondent in the course of the proceedings shall be examined (1) and the ensuing preliminary decision adopted by the majority of the Arbitral Tribunal (2); on the merits, the issue of the applicable law shall be then considered (3).

1. Introduction of a new Respondent in the course of the proceedings

In its reply to the request for arbitration - and subsequently in its statement of defence in response to Claimants' statement of claim, Respondent requested that H be a necessary party in this arbitration which could not proceed without the latter.

It is worth noting that Claimants Nos. 1 and 3 had, in the meantime, brought Claimant No. 2 into the proceedings which was accepted by the Arbitral Tribunal after Respondent had consented thereto.

Irrespective of the legal situation that was prevailing (Claimant No. 2 had been added as a party to the Equipment Agreement), the circumstance just mentioned above illustrates the fact that Respondent had agreed to have Claimant No. 2 brought into the proceedings in the course of the arbitration.

Such a particular case may be characterised as "party joinder". It is generally accepted that a third party may be joined to the arbitration upon the request of one of the parties, in case this is authorised by the relevant arbitration rules and the applicable procedural law; when those rules are silent such a joinder is not possible without the consent of all parties.[1]

In the first instance described above, Respondent requested the introduction of an additional Respondent as necessary party to the arbitration failing which the whole arbitration had to be dismissed, whilst Claimants, rejecting Respondent's request, argued *inter alia* that they were entitled to decide against which party they wanted to proceed in the arbitration.

The Rules of the Arbitration Institute of the Stockholm Chamber of Commerce ("SCC Rules") do not deal with party joinder, like, as example, the Arbitration Rules of the United Nations

[1] See Observations made by Bernard Hanotiau on the arbitral award rendered in 2001 in SCC Case 9/2001 in the *Stockholm Arbitration Report*, 2002:1, p. 137.

Commission on International Trade Law ("UNCITRAL") and the (1998) Arbitration Rules of the International Chamber of Commerce ("ICC Rules").

Especially, Article 4 (6) of the ICC Rules only provide for joinder of cases in instances where two cases are pending before the ICC between the same parties, in connection with the same legal relationship and that the Terms of Reference have not been signed or approved; an arbitral tribunal had decided in a partial award rendered in ICC Case No. 5625 that under the ICC Rules, the Arbitrators once they have been nominated, have no discretion to add as parties to arbitration Claimant (s) or Defendant (s) who were not identified as such in the Request for Arbitration.[2]

In contrast, the London Court of International Arbitration Rules ("LCIA Rules") grant the power to the Arbitral Tribunal to allow, upon the application of a party, one or more third persons to be joined in the arbitration as a party, provided any such third person and the applicant party have consented thereto in writing, and thereafter to make a single final or separate wards, in respect of all parties so implicated in the arbitration (Art. 22.1 (h) of said rules).

As a further example, Article 41 (1) of the Netherlands Arbitration Institute Arbitration Rules provides that a third party who has an interest in the outcome of arbitral proceedings to which these rules apply may request the arbitral tribunal for permission to join the proceedings or to intervene therein; Article 41 (4) specifies that such a joinder may only be permitted by the arbitral tribunal, having heard the parties and the third party, if that third party accedes to the arbitration agreement by an agreement in writing between the latter and the parties to the arbitration agreement.

As to the applicable law at the place of arbitration, the Swedish Arbitration Act of 1999, similarly, does not contain any provision in respect of a party joinder, unlike, for instance, the Belgian Judicial Code (Article 169 bis) or the Dutch Code of Civil Procedure (Article 1045) which provide that a party may serve a notice of joinder on a third party and that such a joinder, to be admitted, requires an arbitration agreement between the third party and the parties in dispute and the unanimous consent the arbitral tribunal.

In the instant matter, the joinder was requested by Respondent after the Claimants had filed their request for arbitration and with the latter not having consented to the joinder, in view also of the absence of any provision dealing with joinder, either in the SCC Rules or the Swedish Arbitration Act.

2. Separate award on jurisdiction with dissenting opinion

The Arbitral Tribunal had therefore to decide the issue of H's joinder in this arbitration under the legal and factual circumstances described above.

The majority of the Arbitral Tribunal, in its award of April 14, 2000, did not examine whether Respondent's request for joining H as a party in the arbitration was admissible at that stage of the proceedings.

[2] *Collection of ICC Arbitral Awards*, p. 484 and ff. at 493 with note of Sigvard Jarvin; see also 4 *International Construction Law Review* (1987), p. 239.

The arbitrators (including the dissenting arbitrator) focused their attention o the issue of the existence of an arbitration agreement between Claimants and H. They exercised their jurisdictional power pursuant to Section 2 of the Swedish Arbitration Act which provides that the arbitrators may rule on their own jurisdiction to decide the dispute.

Although the arbitrators referred, in the examination of this issue, to the existence of a "valid" arbitration agreement, they did not discuss the validity of any possible arbitration clause; instead, they discussed the mere existence of an arbitration clause between Claimants and H, to examine, after having concluded negatively, the scope of the arbitration agreement contained in the Equipment Contract and its relationship with the Modified Contract, especially in light of the Respondent's alternate submission that the arbitration clause did not apply to the claims arising in connection with the Modified Agreement.

Interestingly, the dissenting opinion expressed a different approach in the disposal of the issue of existence of an arbitration agreement. Even though the arbitrators had decided to follow Respondent's request in deciding by way of a separate award in accordance with Article 34 (1) of the SCC Rules and Section 29 of the Swedish Arbitration Act, the dissenting arbitrator expressed his reservation to have the issue settled before oral hearings take place insofar as it appeared to be integrally related to the merits of the claims. The Arbitral Tribunal was not compelled to organise such a hearing, as a preliminary step, as no party had requested it; this was consistent with Article 25 of the SCC Rules which provides that an oral hearing shall be arranged if requested by either party.

Regarding the dissenting opinion itself, it is worth noting that the dissenting arbitrator was authorised to file such an opinion by virtue of Article 32 (4) which provides that an arbitrator may attach a dissenting opinion to the Award. The SCC Rules confirm an established practice in international arbitration, although not necessarily formalised by the arbitration rules of other arbitral institutions such, as example, the ICC or the LCIA.

3. *Applicable law : do stipulations in the contract take precedence over the Vienna Convention for International Sale of Goods ("CISG") ?*

The Equipment Contract did not provide for the law governing the dispute. Respondent submitted that the laws of Canada should govern this arbitration, this being the jurisdiction with the closest connection to the subject matter of arbitration; this also meant that the CISG was applicable according to Respondent.

Article 24 of the SCC Rules provides that the Arbitral Tribunal shall decide the merits of the dispute on the basis of the law or rules of law agreed by the parties; in the absence of such an agreement, the Arbitral Tribunal shall apply the law or rules of law which it considers to be most appropriate. Such a provision is quite similar to those contained in Article 17 (1) of the ICC Rules.

In the instant matter, it is worth noting that the Arbitral Tribunal did not make any determination of the law applicable to the parties' contract; it did even not consider Respondent's submission to apply the CISG. Instead, the arbitrators settled the dispute on the basis of the provisions contained in the Equipment Contract.

It can therefore not be concluded from the manner with which the Arbitral Tribunal has disposed of the case on the merits that the contract took precedence over the CISG, be it supposed that it was applicable.

Presumably, the Arbitrators considered that the Equipment Contract was such as resolving all legal issues placed before them, the contract being the law of the parties.

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