

**UK COURT OF APPEAL CONSIDERS THIRD PARTIES' RIGHT TO
ARBITRATION**

Fortress Value Recovery Fund I LLC & Ors v Blue Skye Special Opportunities Fund LP & Ors [2013] EWCA Civ 367

Introduction

In *Fortress Value Recovery Fund I LLC & Ors v Blue Skye Special Opportunities Fund LP & Ors* [2013] EWCA Civ 367, the Court of Appeal considered the circumstances in which a third party would be treated, under the Contracts (Rights of Third Parties) Act 1999, as a party to an arbitration agreement contained in a contract to which the third party is not a party.

Background

The claimants brought court proceedings in England and Wales against the defendants following a restructuring of assets held in an investment holding structure. The claimants alleged that the defendants, as managers of the Blue Skye Fund, acting in concert with three other individuals and twelve corporate entities, designed and implemented a dishonest scheme to reorganise the fund and its assets, the purpose and effect of which was to diminish or to eliminate the rights and interests of the partners in the fund in relation to the assets, to take the control and benefit of the assets themselves, and to enable them and their associated entities to extract fees and other value from the assets.

While the claimants, who were shareholders and creditors of one of the limited partners, were parties to the partnership deed, the defendants (who were managers of the partnership) were not parties to the partnership deed although they were entitled to the benefit of indemnities and exclusion clauses contained in that partnership deed. Those clauses provided that:

17.2.1 Neither the General Partner nor any of its Associates shall have any liability for any loss to the Partnership or the Partners arising in connection with the services to be performed hereunder or pursuant hereto, or under or pursuant to any management agreement, advisory agreement or other agreement under which it provides or agrees to provide services to or in respect of the Partnership or which otherwise arises in relation to the operation, business or activities of the Partnership...

17.2.2 The Partnership agrees to indemnify and hold harmless out of Partnership Assets the General Partner and any Associate (the "Indemnified Party") against any and all liabilities, actions, proceedings, claims, costs, demands, damages and expenses (including legal fees) incurred or threatened by reason of the Indemnified

Party being or having acted as a general partner or manager in respect of the Partnership or arising in respect of or in connection with any matter or other circumstance relating to or resulting from the exercise of its powers as a general partner or manager or from the provision of services to or in respect of the Partnership...

The defendants, seeking a stay of the court proceedings under section 9 of the Arbitration Act 1996, argued that they should be entitled to enforce the arbitration clause contained in the partnership deed by virtue of the provisions of the Contracts (Rights of Third Parties) Act 1999 (the “1999 Act”) (expressly referred to in the partnership deed) which permits a third party, in certain circumstances, to enforce the provisions of a contract to which it is not a party. The arbitration clause at issue provided:

17.11 Governing Law

This Agreement and the rights, obligations and relationships of the parties hereto under this Agreement shall be governed by and construed in accordance with the laws of England and Wales. Any dispute, controversy or claim arising out of or in connection with this Agreement or the formation, breach, termination or invalidity thereof, that the parties hereto are unable to resolve between themselves, shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce of Paris by three arbitrators appointed in accordance with the aforementioned rules. The place of arbitration shall be London, UK. All submissions and awards in relation to arbitration under this Agreement shall be in English, and all arbitration proceedings and pleadings shall be in English.

At first instance, the High Court held that the defendants were not to be treated as parties to an arbitration agreement in the deed by virtue of the Contracts (Rights of Third Parties) Act where they did not rely in their defence on a substantive term of the deed; and so could not seek a stay under section 9 (<http://www.bailii.org/ew/cases/EWHC/Comm/2012/1486.html>).

The defendants appealed.

Judgment

In an unanimous decision, the Court of Appeal upheld the decision of the High Court, on different grounds.

In particular, Tomlinson LJ did not consider that the distinction drawn by the judge between a right of action and a contractual defence could in this context be sustained:

- The distinction between a right of action and a contractual defence was a relevant but not determinative factor.
- The right to take the benefit of a contractual exclusion may, under the 1999 Act, be subject to a term providing for the submission of disputes to arbitration, and this was a question of construction of the agreement.
- When construing the agreement in order to ascertain the intention of the parties thereto, it would be easier to conclude that the parties intended enforcement of the contractual indemnity by a third party to be subject to the arbitration provision than it

would be to conclude that the parties intended reliance on the contractual exclusion by a third party to similarly be subject to the arbitration provision.

While in agreement with the judgment of Tomlinson LJ, Toulson LJ also draw a distinction between a procedural qualification of a substantive right given to a third party under section 8(1) and the grant of a procedural right under section 8(2) of the 1999 Act.

- Under 8(1), the third party was entitled to a substantive benefit under the contract, subject to a procedural condition that the third party may enforce it only by a particular process, i.e. arbitration;
- Under 8(2), a term of the contract gives a unilateral right to the third party to require that a dispute should be submitted to arbitration, so treating the third party as a party to an arbitration agreement with the party to the contract if and when the third party exercises the right

Toulson LJ emphasised that there is a clear difference between the objects of section 8(1) and 8(2); and that if parties want to give a third party a procedural right to have disputes referred to arbitration, section 8(2) provides the way to do so.

29th April 2013