Third-Party Notice in Arbitration Proceedings – A Proposal from Germany

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On 3 March 2021, the German Arbitration Institute (DIS) held an online event for the discussion of a proposal for the introduction of third-party notice in the DIS arbitration rules. The proposal comes at a point in time when hundreds of mooties are preparing for this year's edition of the Willem C. Vis Moot which includes arguing for and against the forceful joinder of a third party in a hypothetical arbitration under the rules of the Swiss Chambers' Arbitration Institution (Swiss Rules).

Third-Party Notice Explained

Notice to third parties is a popular tool in German civil procedure. Under s. 72 of the German Code of Civil Procedure ("**CCP**") a party to a court proceeding that expects to raise warranty claims or a claim to indemnification against a third party should the legal dispute's outcome not be in its favor may file a third-party notice with the court. The court serves the notice to the third party with the effect that the party may join the proceeding. If the third party refuses to accede to the proceedings, the legal dispute will be continued without its interests being taken into consideration (s. 74 para. 2 of the German CCP).

What makes the notice a powerful dispute resolution tool is that the third party in a subsequent proceeding cannot defend itself against the notifying party alleging that the legal dispute has been ruled on incorrectly; an allegation by the third party that the primary party had pursued the proceedings inadequately, will be heard only under extraordinary circumstances (s. 68 of the German CCP). Similar models of third-party notice also exist in other jurisdictions (e.g. Austria, or Switzerland). As Prof. Dr. Antje Baumann pointed out in her introduction, third-party notices are used quite regularly in disputes where claims for redress are to be expected, e.g. supply chain or construction disputes.

The Baseline for Third-Party Notice in Arbitration

Initiating the discussion, Professor Dr. Borris elaborated on the advantages that third-party notices could have in arbitration, including that:

- the main proceeding is minimally affected by the notice, because the proceeding would continue regardless of the third party joining the dispute or not;
- the effect of the notice is rather limited and target-oriented – the notified party may join the proceeding and has the chance to defend its interests, but cannot purposefully delay the main proceeding;
- even if the third party does not join the main proceeding it has to bear the consequences.

Professor Borris explained that the minimum standards for multi-party arbitration were set in 2009 when the German Federal Court confirmed the arbitrability of disputes concerning the validity of a shareholder resolution in a limited liability company ("*Schiedsverfahren II*", German Federal Court, 6 April 2009, docket no. II ZR 255/08). The Court reasoned that the arbitration agreement should only be binding if, among others, the following minimal prerequisites were fulfilled:

- all affected parties (here: shareholders) are bound by the same arbitration agreement;
- all affected parties have the possibility to participate in the arbitration;
- all affected parties have the possibility to participate in the selection and appointment of the members of the arbitral tribunal.

These minimum prerequisites thus also should be considered as the basis for discussions of third-party notices in arbitration. The strict requirements laid out in German jurisprudence, however, make the involvement of third parties “difficult”, which explains the rather long text of the draft proposal.

Alternatives to a proposal for new rules were discussed briefly. For instance, Article 4.2 of the Swiss Rules, which allows the joinder of third parties, was considered very broad, because it would be possible to involve third parties (i) without binding arbitration agreement for the third party, (ii) without consent of the third party, (iii) without possibility to influence composition of arbitration panel. Professor Borris noted that it was doubtful whether such a broad rule would be accepted by German courts.

A Draft Proposal for Supplemental Arbitration Rules on Third-Party Notices

Dr. David Quinke then presented the draft proposal for supplemental arbitration rules on third-party notices. In contrast to corporate disputes, where an arbitration agreement may be included in the corporation’s bylaws or a shareholder agreement, other disputes do not necessarily arise in the context of an arbitration agreement that is binding for all involved parties. To solve this problem and comply with requirements set by the German Federal Court for the arbitration of shareholder disputes, all parties would have to anticipate their consent to third-party notices and the effects thereof in separate declarations, presumably in their respective arbitration agreement (opt-in required, Art. 1 of the draft proposal).

In order to fulfill the requirement that all parties involved must be able to influence the constitution of the tribunal, it is necessary that third-party notices are only possible before the tribunal is constituted. After the constitution of the tribunal, notices are only admitted if all the parties, including the third party, consent (Art. 2 of the draft proposal). The notified party may give notice to additional third-parties under the same prerequisites.

The notified party may join in assistance of the notifying party. Joinder on the adverse party’s side is only possible with express consent of the adverse party. As a joined party, the third party may file requests to the tribunal in defense of its interests, but may not contradict the main party of the proceedings, e.g. the joined

party may not acknowledge claims against the notifying party's requests (Art. 3 of the draft proposal).

Articles 4 and 5 of the draft proposal establish how arbitrators are selected in a multi-party arbitration, either through agreement or through the DIS Appointing Committee. Articles 7.1 – 7.4 of the draft proposal specify the effects of the third-party notice to be the same as in a German court proceeding (s. 74 and s. 68 of the German CCP, see above). Article 8 of the draft proposal entitles the joined third party to claim procedural costs as if it were a main party.

Lean on Me

Bill Withers offers in his 1972 song that anybody may lean on him, if they are not strong, and yet, under the current DIS arbitration rules it is comparably difficult for respondents to lean on third-parties during arbitration. This is particularly unfortunate if all the affected parties are willing to conduct a proceeding that efficiently leads to a result with binding effect for all.

Professor Dr. Elsing pointed out that the draft proposal for third-party notices opens useful options for parties in such situations. He illustrated the advantages and disadvantages of arbitration for the scenario of a plant construction with a general and sub-contractor, and a post m&a dispute.[fn]In the case of a plant construction, the employer may claim compensation for defects from the general contractor in an arbitration. Under the current DIS Rules, the general contractor can involve the subcontractor in the proceeding only if there is "an arbitration agreement that binds all of the parties" (Art. 18.1 DIS Rules) and only by stating specific relief against the subcontractor (Art. 19 DIS Rules). The employer, however, will not consent to a multi-party arbitration agreement, as this would increase complexity in the arbitration. Under the draft proposal, the general contractor could give notice to the subcontractor of the arbitration, who may or may not join and support the general contractor. The employer would not have to fear unnecessarily increased complexity as claims between the contractors would not be subject to arbitration. Conversely, if the subcontractor commences arbitration against the general contractor claiming compensation for overhead costs due to delays, the general contractor could give notice to the employer, who could participate in the arbitration and ensure that the reasons for the delays are

correctly analyzed without complicating the proceeding.[/fn] Professor Dr. Münch too commended the effort to use arbitration as a dispute resolution method that is more flexible than court proceedings. He suggested that DIS should consider publishing case-specific model clauses for third-party notices. With the right clause, it could be ensured that all the affected parties agree to the effects of a multi-party process.

The draft proposal will be discussed in more detail before possibly being adopted since there still remain some gray areas to be tackled For instance, Article 7.5 establishes that a third-party notice suspends the statute of limitation under German law. In case German law applies, a third-party notice in a court proceeding would suspend the statute of limitation for claims against the third party, and the drafters of the proposal wanted to clarify that a third-party notice in arbitration has the same effect. Still, this statutory law-type provision seems a little out of place in case German law is not applicable to the merits of the case.

Ideally, representatives from industries in which multi-party situations in arbitration are the norm rather than the exception (e.g. from the construction, m&a, or w&i insurance sector) should be given the opportunity to voice their position as to whether complex problems really require complex solutions. Eventually, the draft proposal could be adopted as an annex to the DIS Rules together with a model clause, which would not necessarily require a reform of the Rules. In the same vein, Dr. Francesca Mazza, the DIS Secretary General, noted that there was no immediate need to reform the DIS rules of arbitration. Instead, parties who want to take advantage of the flexibility in arbitration proceedings should agree on specific rules for the involvement of third parties in their arbitration agreements. In order to work on model clauses for third-party notice, among others, DIS invites its members and anybody interested to participate in a clinic, where the specifics of such solutions will be discussed.

This conclusion – no immediate reform of the rules, but discussions of ideas for solutions that can be used immediately by any interested party – ties in well with Santtu Turunen’s considerations with regard to an arbitration institution’s value propositions in this blog: The main goal should be to make dispute resolution more efficient and provide solutions for parties in complex situations. A reform of the rules does not seem necessary, if the same can be achieved with new models for arbitration agreements.