

## Construction- Switzerland

### Standing of Consortium Members in Consortium Disputes with Third Parties

Contributed by LALIVE

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#### Case Comment

A recent Swiss Supreme Court decision addresses an important practical issue that frequently arises in international construction disputes: the standing of consortium members to sue and to be sued.<sup>(1)</sup>

#### Case

A Ltd and B Corp formed a contractual consortium for the installation of air conditioning and the supply of mechanical equipment for real estate projects. The consortium entered into a subcontract with the main contractor, Y Ltd. Changes in the projects caused additional work. B contacted Y and negotiated prices for the additional work to be performed by the consortium. A price reduction was agreed. A was informed merely of the outcome of the negotiations, and of the fact that its own prices would be reduced too. As a result, A withdrew from the site. Y continued to perform the works alone, without the consortium. Subsequently, Y took over B. A sued Y for works performed by A before its withdrawal from the site, invoiced at the prices initially agreed. A requested payment to itself and, alternatively, to the consortium. Y raised a counterclaim for excess payments it had made to the consortium.

The cantonal court rejected A's claim and deferred its decision on the counterclaim to a later stage. A appealed the decision to the Supreme Court, which upheld the lower court's decision, ruling that A lacked standing. Under Article 544 of the Code of Obligations, claims brought by a consortium must be made jointly by all members of the consortium. No single partner can make an individual claim unless all members have agreed.

Unfortunately, the decision does not report the full case history. It appears from the text of the decision that A had sued its consortium partner B in order for B to authorize A to bring the claim against Y. B seemed to have had authority under the consortium contract to negotiate with the main contractor and to make binding undertakings. On the other hand, the partners seem not to have addressed whether one of them could alone sue under contracts which they had entered into with third parties, such as Y.

The Supreme Court added that in the context of a consortium, the lack of standing to sue does not exclude the consortium's standing to be sued. While all partners must claim together, third parties can bring a claim against any of the consortium partners individually. Indeed, under Section 544 of the Swiss Code of Obligations, all partners are jointly and severally liable to third parties.

#### Comment

Contracts providing for the cooperation of contractors, such as consortium contracts, partnership agreements and joint ventures, should address expressly the consortium's relationship with third parties. If the members of the consortium sign a contract with third parties jointly, they should clearly determine the circumstances in which one of the partners can (or must) alone negotiate with, settle claims and sue the third party. This should be done at the outset, when entering into the

consortium agreement. Once a dispute with the third party arises (typically the employer or another contractor), all partners may no longer have the same interests. For instance, one of the partners may have more to lose and be obliged to take a more aggressive stance with respect to the employer than another, which may hope for future work assignments or which, as in the present case, has been taken over by the 'enemy' (the employer). The contract should also address whether and how a member of the consortium or a group of members can act as 'pilots' and negotiate with the employer/main contractor. Duties to inform and to obtain prior instructions and approvals from the other members should be stated. The liability of the pilots can be reserved.

While the lack of proper language in the joint venture contract might be fatal to a partner's individual claim in a purely domestic situation, international arbitral tribunals may have more discretion than courts to admit claims brought by a partner alone. Of particular interest in this context is the case law of the Iran-US Claims Tribunal, a treaty-based arbitral tribunal that dealt with thousands of claims brought by international investors against Iran after the Islamic revolution. Many of the foreign investors were organized as partnerships or joint ventures. Some of the partnerships also comprised Iranian partners which did not participate in proceedings against Iran. Other partnerships could not agree on bringing a claim on behalf of the partnership. In these situations the question arose as to whether one of the partners could act alone before the tribunal. The tribunal admitted in a number of cases the standing of a partner to claim on its own, to the extent that the claim covered only its own interests and that the latter were distinguishable and separable from the other partners' claims.<sup>(2)</sup>

If the contract with the third party contains an arbitration agreement and is not signed by all partners, problems of standing are compounded. In many jurisdictions only signatories are entitled to commence arbitration. Likewise, arbitration is possible only against the signatory third party (eg, the subcontractor, owner or supplier). In practice, only some of the interested parties commonly sign the contract, whether on the consortium's side or on the side of the third party. Thus, the signatory parties might not be identical to the party that ultimately performs or has an interest in the contract. The signatory contractor might act through affiliates or itself be a controlled affiliate. The state authority acting as owner might be directly controlled by a ministry. The consortium partners might not sign jointly, but act through a pilot. Modern arbitration (case) law may permit the extension of the arbitration clause to non-signatories, but there are prerequisites for such extensions, and it would be more prudent for the consortium to ensure that all parties that may want to rely on the arbitration clause actually sign an instrument allowing such reliance.

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## Endnotes

(1) Decision 4C.352/2006 of January 25 2007.

(2) See, in particular, *Housing and Urban Services International Inc v The Government of the Islamic Republic of Iran*, Award 201-174-1, 9 Iran-US CTR 313.

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