

**LEGALUPDATE**

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**CASE UPDATE****ARBITRATION AGREEMENTS MAY NOT BE EFFECTIVE IN DISPUTES INVOLVING NON-CONTRACTING PARTIES****Paharpur Cooling Towers Ltd v Paramount (WA) Ltd [2008] WASCA 110****Executive Summary**

The Western Australian Court of Appeal has ruled that the principle of “*one stop adjudication*” in the context of arbitration agreements may not apply where the dispute is not confined *solely* to the parties to the arbitration agreement.

In such a situation, the court may, as it did in the present case, conclude that the dispute is incapable of settlement by arbitration and allow the liabilities of all the parties concerned – including those of the parties to the arbitration agreement – to be determined in a court action.

**Brief Facts**

An equipment supply contract (the “**Contract**”) between Paharpur Cooling Towers Ltd (the “**Plaintiff**”) and Paramount (WA) Ltd (the “**Defendant**”) contained a dispute resolution clause (the “**Arbitration Agreement**”) that permitted any “*dispute or difference between the parties*” as to the Contract to be settled by arbitration or litigation at the Defendant’s election.

Following disagreement on several issues, the Plaintiff eventually commenced a court action against the Defendant and other persons, including a company known as Burrup Fertilisers Pty Ltd (“**BFPL**”). One of the claims involved a dispute between the Plaintiff (as a drawer/payee under a bill of exchange) against both the Defendant as well as BFPL (as alleged co-acceptors under the bill of exchange) (the “**Bill of Exchange Dispute**”). BFPL was not a party to the Contract or the Arbitration Agreement.

After the Plaintiff commenced the action, the Defendant served on the Plaintiff a notice referring all the matters in dispute between them to arbitration. The Defendant then applied to the court for a stay of the action insofar as it related to the Defendant. The stay application was brought on a number of grounds, including Section 7 of the Australian International Arbitration Act. This statutory provision would have obliged the court to stay the Plaintiff’s action in respect of any matter that, in pursuance of the Arbitration Agreement, was capable of settlement by arbitration.

**Decision of the Western Australian Court of Appeal**

The court held that the Bill of Exchange Dispute could not be settled by arbitration under the Arbitration Agreement. As such, it was not required by Section 7 of the Australian International Arbitration Act (or on any other basis) to stay the action concerning the Bill of Exchange Dispute. The court action in respect of the Bill of Exchange Dispute was accordingly allowed to proceed.

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*“One stop adjudication” principle has limited application if dispute involves non-contracting parties*

The court acknowledged that the relevant authorities indicate that parties to a commercial agreement who have included an arbitration clause are likely to have intended that all disputes concerning them should be resolved by arbitration.

However, this principle of “*one stop adjudication*” does not readily apply in cases where the parties’ dispute also involves other persons who are not parties to the arbitration agreement. The reference in the Contract to a “*dispute or difference between the parties*” was intended to apply to a dispute between the parties to the Contract *only*. It did not apply to a dispute involving the parties *as well as* a stranger to the Contract, such as BFPL.

*Parties unlikely to have intended “fragmented” dispute adjudication*

The court was of the view that the Plaintiff and the Defendant could not have intended at the time of contracting (if they had foreseen this scenario, which they did not) that the liability of the Defendant and BFPL in the Bill of Exchange Dispute would be dealt with and determined in two separate forums, one arbitral and one judicial. The court noted that:

*“it will generally be ... difficult to ascribe to the parties to the arbitration agreement an intention that in such an event the dispute should be fragmented and that the liability of the party to the arbitration agreement and that of the third party respectively should be determined in different forums”.*

To hold that the Plaintiff and the Defendant contemplated otherwise would be inconsistent with the commercial purpose of the Contract and result in a “*duplication of proceedings that will be costly, inefficient and time-consuming, and give rise to the unwelcome possibility of inconsistent decisions of the different tribunals involved*”. In the final analysis, “*it will commonly result in the very opposite of what the parties ordinarily set out to achieve by an arbitration clause*”.

## Comment

This decision highlights the need, when preparing transaction documents, to consider whether provision ought to be made for the consolidation of disputes involving different parties and different contracts. It routinely happens that the ancillary – but related – transaction documents do not share a common dispute resolution mechanism. This case underscores the importance of drafting arbitration clauses clearly to take account of such other related contracts and the myriad disputes (possibly involving different parties and different contracts) which may arise in practice.

If you would like more information about this case or wish to discuss how it may potentially affect you or your business, please feel free to contact the dispute resolution lawyers in Drew & Napier LLC (please refer to the Directors’ Profiles on our website), or:

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