Multi-tiered dispute resolution clauses are being used more often in commercial contracts, but are they a good idea? Jonathan Cotton reports.

It is becoming increasingly common in commercial contracts, in a variety of different sectors and size of contract, for the dispute resolution clause to provide not just for submission to a chosen national court or for arbitration to take place in Paris, New York, London or elsewhere, but for prior, alternative dispute resolution steps to be taken before proceedings start before a judge or an arbitrator.

Multi-tiered dispute resolution clauses can provide for various different steps before litigation or arbitration, including escalation of the dispute to increasingly senior executives of the relevant parties, and/or for reference to experts or to mediation pursuant to an established set of rules such as those of the Centre for Effective Dispute Resolution (CEDR) or the ICC ADR rules.

By way of example, a multi-tiered clause could encompass:

- discussion/negotiation between the most senior persons conducting the relevant activity for each party, such negotiation to take place after one party invokes the clause through service of a notice and such negotiations having to take place within a specified period and be concluded within a further specified period; failing settlement through that mechanism, then

- escalation to the finance directors or CEOs of each party for discussion/negotiation, again with a specified period for the holding of such negotiations; failing settlement through that mechanism, then

- mediation under a set of pre-agreed mediation rules; failing settlement through that mechanism, then

- reference of the dispute to arbitration or (certainly not ‘and’, although drafts purporting to include both arbitration and then litigation do appear from time to time) submission by the parties to the jurisdiction of the agreed national court.

The increasing use of these clauses raises a number of questions, such as whether a party should agree to such a clause in its contracts, and the related question of whether they are enforceable at all. In cases where the clause provides for ultimate dispute resolution by arbitration, there is the added complication of the arbitrator’s own jurisdiction potentially being wholly absent if there is a failure to comply with the earlier ADR tiers.

**Pros and cons**

Parties presumably include multi-tiered clauses in contracts on the basis that they believe they will be better served by them than by the straight submission of their disputes to the chosen court or to arbitrators, as the case may be. These clauses are obviously designed to facilitate a more rapid and cost-effective settlement of disputes than the more traditional methods of resolution. If such clauses cause parties to behave in ways that increase the prospects of settlement at an early stage of a dispute, then that is potentially highly valuable. Other than anecdotal evidence, however, there is no way of knowing if such clauses in fact assist parties to settle any earlier than they otherwise would have done.

But if a party is determined not to play ball, then even if the preliminary tiers of the clause are enforceable, the clause cannot guarantee that it will be effective in assisting early settlement, since negotiation and mediation are entirely reliant on both parties’ goodwill. A recalcitrant party may pay lip-service to the clause, and indeed negotiate or mediate as the case may be, but in reality not be committed to finding a solution to the problem at that stage. Some practitioners are also wary of a multi-tiered clause since it may allow a party to engage in tactical negotiations and delay under the cover of apparent compliance with the contract.

There is also a danger that the existence of the earlier tiers of the clause will make the resolution of a particular dispute unwieldy and cause delay, possibly to one party’s
tactical advantage over the other, especially if urgent relief is needed. In cases where quick enforcement of rights, particularly payment obligations, is likely to be required, the use of a multi-tiered clause should be considered carefully before inclusion.

However, while it is impossible to compel the parties to negotiate meaningfully or to reach a settlement, careful design of a multi-tiered clause can guide the parties into a structured process, ultimately enhancing their opportunity of early settlement.

Are such clauses enforceable?

Even if it is concluded that such clauses are worthwhile, it is important for parties to know whether they will be able to hold their counterparties to the clause in the event that a dispute does arise.

A good place to start when considering the enforceability of multi-tiered clauses is the House of Lords’ judgment in *Channel Tunnel Group v Balfour Beatty Construction Ltd* [1993]. The construction contract in this case contained a dispute resolution provision that provided for two relevant steps: first, reference to a panel of three experts; and secondly, within 90 days of receiving the expert panel’s decision, a dissatisfied party could make a reference to ICC arbitration. One of the parties sought to bypass both the expert limb of the clause and the arbitration provision by seeking an interim injunction from the court.

Lord Millett said that:

‘The parties here were large commercial enterprises, negotiating at arm’s length… it is plain that [the dispute resolution clause] was carefully drafted, and equally plain that all concerned must have recognised the potential weaknesses of the two-stage procedure and concluded that despite them there was a balance of practical advantage over the alternative of proceedings before the national courts… Having made this choice… it is in accordance… with the interest of orderly regulation of commerce, that having promised to make their complaints to the experts and if necessary to the arbitrators, that is where the appellants should go. The fact that the appellants now find their chosen method too slow to suit their purpose, is to my way of thinking quite beside the point.’

This obviously supports the proposition that, where parties provide for some prior method of determining their dispute other than arbitration or litigation, this should be respected. It was clear in *Channel Tunnel Group* that the House of Lords did not consider that there was any problem with enforcing the reference to the experts as a first step before going to arbitration. Further, in 1996 the Arbitration Act of that year appeared to include in s9(2) recognition that court proceedings brought in breach of an agreement to arbitrate could be stayed in favour of arbitration even where the reference to arbitration could not be made immediately because the parties had agreed first to use other dispute resolution mechanisms.

By way of contrast to the use of determinative procedures prior to arbitration, such as the reference to an expert in the *Channel Tunnel* case, the use of clauses that required negotiation (including mediation) before reference to court or arbitration was more uncertain. In *Walford v Miles* [1992] the House of Lords confirmed that English law does not recognise a contract to negotiate in good faith. As applied to multi-tiered clauses, this was thought to mean that any requirement to negotiate or mediate before going to arbitration or litigation, ie a non-determinative process, would not be enforceable: *Halifax Financial Services v Intuitive Systems* [1999].

However, in 2002 the Commercial Court held in *Cable & Wireless v IBM* that, although there is no common law obligation to negotiate in good faith, if an alternative dispute resolution process is set out in the agreement (for example by reference to the procedure of an ADR institution), the obligations of parties are reasonably certain and thus enforceable. This decision is in line with an earlier decision in Australia, *Alton Australia Pty Ltd v Transfield Pty Ltd* [1999], in which the court held that it ‘will not adjourn or stay proceedings pending alternative dispute resolution procedures being followed, if the procedures are not sufficiently detailed to be meaningfully enforceable’ but that ‘provided that no stage of the dispute resolution mechanism is itself an “agreement to agree” and therefore void for uncertainty, there is no reason why, in principle, an agreement to attempt to negotiate a dispute may not itself constitute a stage in the process’.

In *Cable & Wireless Colman J* held that the ADR element of the multi-tiered clause was enforceable, and as a result stayed the proceedings to allow the parties to commence CEDR mediation as required by their agreement. He stated that the agreement left ‘no doubt that when the parties negotiated the agreement it was the mutual intention that litigation was to be resorted to as a last resort in the event that negotiation by means of the escalation process… or, failing that, ADR… were unproductive’. 
He distinguished the dispute resolution clause in the contract from a simple agreement to negotiate in good faith to reach a settlement due to the parties’ nomination of CEDR, ‘one of the best-known and most experienced dispute resolution service providers in the country’. The clause could therefore ‘be analysed as requiring not merely an attempt in good faith to achieve resolution of a dispute but also participation of the parties in a procedure to be recommended by CEDR’. The result was that any breach of the clause, such as a failure by one party to attend before the mediator, could be ascertained.

In a clear statement in support of multi-tiered clauses, Colman J said in Cable & Wireless that ‘for the courts to decline to enforce contractual reference to ADR on the grounds of intrinsic uncertainty would be to fly in the face of public policy’. He further held that a broad reference to negotiation or mediation that did not include an identifiable procedure would not necessarily be unenforceable due to uncertainty, stating that ‘where there is an unqualified reference to ADR, a sufficient certain and definable minimum duty or participation should not be hard to find’. This statement recognises the court’s ability to imply a minimum standard and determine as a matter of fact whether the standard has been breached.

The specific arbitration context

In the context of a clause that has as its last step recourse to the courts, the court may be prepared to stay the proceedings in front of it in order to enforce the bargain that the parties engage in the agreed processes first, although clearly this is discretionary. This is what happened in Cable & Wireless.

However, in the context of arbitration, the arbitrators have no jurisdiction to adjudicate on the parties’ dispute other than that given to them by those very parties in their agreement to arbitrate. If arbitration is the last tier in a multi-tiered clause that requires some other steps be taken before reference to arbitration, the arbitrators and parties ought to consider very carefully whether those steps have been observed and the consequences of any failure to do so. Cases such as JT Mackley & Co Ltd v Gosport Marina Ltd [2002] and Holloway & anr v Chancery Mead Ltd [2007] confirm that clauses that require some ADR process before arbitration can be considered conditions precedent to it. In the latter case Ramsey J also held that, to be enforceable, the ADR elements of a multi-tiered clause must meet at least the following three requirements:

- the process must be sufficiently certain so no further agreement is required for the matter to proceed;
- the process for selecting the person to resolve the dispute, and to pay that person, must be defined; and
- the process, or at least the model of a process, should be set out so that the details are sufficiently certain.

If there is a condition precedent to the parties’ agreement to arbitrate their dispute, it follows that a failure to satisfy it will lead to the persons purported to be appointed as arbitrators having no jurisdiction, although of course they are allowed to rule on their own jurisdiction or lack of it (s30 Arbitration Act 1996). However, it also follows that if they rule that they have no jurisdiction, that is the end of the arbitration: they are functus officio and, unlike Colman J in Cable & Wireless, have no jurisdiction to stay the arbitration at their discretion pending the satisfaction of the condition precedent, and send the parties away to pursue their ADR mechanism. A finding of lack of jurisdiction can have significant costs and delay consequences. The parties will not only have to go through the ADR process, but, assuming the matter does not settle, will have to go back to the start of the arbitration process as well (although in reality that probably means dusting off their papers from their first attempted arbitration).

In the arbitration context, the question of whether the ADR element of the multi-tiered clause is a condition precedent to the agreement to arbitrate is therefore particularly important. Whether any particular clause is a condition precedent will, of course, depend on the wording used. If the steps in the various tiers of the clause are clear, certain and otherwise enforceable, and the language used is that of obligation, then a failure to comply with the earlier ADR tiers points to the conclusion that the parties’ agreement to arbitrate was conditional on their having first gone through those tiers. Words of obligation such as ‘shall’ point to the ADR provisions being mandatory and thus a condition precedent to the agreement to arbitrate. By contrast, where the language of a multi-tiered clause makes the use of the ADR mechanism optional or permissive, arbitrators have found that a party is entitled to submit a request for arbitration whenever it wishes. The use of the words ‘may’ and ‘however’, or general uncertainty as to what is supposed to happen by way of supposed ADR, all point to the ADR provisions not being conditions precedent to arbitration.
Conclusion

There is an increasing acceptance as to the enforceability of ADR provisions of multi-tiered clauses. Both determinative procedures, such as reference to experts, and non-determinative procedures, such as negotiation or mediation, are potentially enforceable and the latter can no longer be categorised as mere ‘agreements to agree’. This obviously has important implications for the drafting of multi-tiered clauses. Care should be taken to be as certain as possible in the procedure to be followed, including what is to happen (for example, by reference to an external set of standards such as CEDR or ICC ADR rules) and how the completion of the ADR elements is to be identified and the next step to be undertaken.

The parties and their advisers also need to consider whether a failure to invoke a prior tier in the clause is intended to prevent a party – until completion of that prior tier – from commencing the ultimate dispute resolution mechanism of court or arbitration. If it is intended that fulfilment of each step is to be a condition precedent to arbitration, the clearest language should be used and parties need to be very careful to observe the process when a dispute arises.

However, by way of postscript, it should be observed that, when a dispute does arise, the parties decide in many cases not to follow the multi-tiered clause in their original agreement. Instead, they agree, explicitly or implicitly, either to leave out some element of the process or to adopt an entirely different dispute resolution process altogether.

*This article was originally published in the Legal Business Arbitration Report 2008.*