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## How to draw up an effective Dispute Resolution Clause

*In this article, which first appeared in the LexisNexis Australian Alternative Dispute Resolution Law Bulletin, 2014 Vol1 No 3, Joachim Delaney of Baker & McKenzie, outlines the importance of making sure that contracts drawn up after transaction negotiations contain an effective dispute resolution clause. Jo highlights and the pitfalls and the unintended consequences that can result from poorly drafted clauses.*

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## Dispute Resolution Clauses: Risks, Options and Drafting Tips

*Joachim Delaney, Special Counsel, Baker & McKenzie*

Negotiating a new transaction may bring new and exciting opportunities and relationships for the parties involved. The risk of potential disputes is often far from the minds of the parties and their advisers at the time of negotiating the terms of the underlying contract. The dispute resolution clause, otherwise known as the "midnight clause" is often added at the "11th hour". A boilerplate clause may be pulled off the shelf, or quickly drafted with little or no consideration as to whether it is appropriate for the potential disputes that may arise out of the particular transaction.

However, ensuring the contract contains an effective dispute resolution clause may be vital to avoiding a costly and time-consuming dispute or to obtaining an enforceable remedy. It may be difficult to agree on alternative dispute resolution options once a dispute has arisen if those options are not already included in the dispute resolution clause. Even if they are included, the clause may not address all the essential elements required to, for example, set up a mediation, without further agreement from the parties. If further agreement cannot be obtained, then the mediation may be frustrated. As a result, the clause may be considered uncertain and unenforceable.

Recent cases have highlighted potential issues that may arise from poorly drafted dispute resolution clauses. This article briefly considers the potential risks and some legal and practical issues to take into account when considering the options available for dispute resolution and provides practical tips for drafting effective dispute resolution clauses, focusing on negotiation, mediation, expert determination, arbitration and litigation.

### **Dispute resolution: potential risks**

Avoidance of disputes is often the key objective of the parties. For this reason, dispute resolution clauses are often multi-tiered giving the parties the opportunity to resolve their disputes first through negotiation or mediation before referring the dispute to arbitration or litigation. Expert determination may also be included if, for example, it is appropriate for a quick resolution of a technical or construction issue or perhaps a valuation issue by a qualified expert.

In many circumstances, parties will seek to resolve disputes through negotiation before relying on the dispute resolution clause irrespective of whether negotiation is a step required in the dispute resolution clause. Similarly, parties may also agree to mediate a dispute even if there is no such requirement in the clause.

However, a clause that provides for negotiation and/or mediation may open up and facilitate the resolution of a dispute in circumstances where the parties cannot reach agreement. Having said that, there is always a risk that a party will not comply with such requirements and refer the dispute to arbitration or litigation prematurely. There may then be a dispute about whether the requirements to negotiate and/or mediate constitute conditions precedent with which the parties must comply before further steps may be taken. For that reason, it may be advisable not to provide for negotiation or mediation in the dispute resolution clause.

Nonetheless, multi-tiered dispute resolution clauses are increasingly common. If such a clause is to be included then it needs to be drafted carefully. Whilst the clause should be kept simple, its terms must be sufficiently clear and certain such that they can be given legal effect and are thus enforceable. If not, the parties may find themselves in a costly and time consuming dispute about the dispute resolution clause itself, thereby delaying the final resolution of the "real" dispute and exposing a dispute that may have otherwise remained confidential between the parties.

Most importantly, the dispute resolution clause must facilitate an enforceable remedy. The time and expense involved in reaching a final and binding decision will be wasted completely if the losing party refuses to comply with the decision and the remedy cannot be enforced against that party. An unenforceable remedy may be ineffectual or even worthless in such circumstances.

## **Dispute resolution options: legal and practical issues to consider**

Whilst there are now various forms of dispute resolution available to parties, the most common options chosen are: negotiation, mediation, expert determination, arbitration and litigation. For this reason, such options are the focus of this article.

Drafting an effective dispute resolution clause requires consideration of a number of legal and practical issues such as the subject matter and the types of disputes that may arise, the options available and whether they are appropriate for resolving the particular type of dispute, timing constraints on the parties, the location and background of the parties, the importance of confidentiality as well as the types of remedies that may be obtained and whether those remedies are enforceable.

For example, it may be most appropriate for a technical or construction issue that arises during the performance of a contract (such as a large construction project) to be resolved quickly by a qualified expert or by adjudication so that construction is not stalled by a lengthy arbitration but may continue within a matter of months. Such accelerated dispute resolution would address the parties' time constraints.

Parties of certain national or cultural backgrounds may be more comfortable with conciliatory forms of dispute resolution such as negotiation, mediation or conciliation rather than adversarial arbitration or litigation. Arbitration may provide parties of different nationalities with a process that is more informal and flexible than the courts such that it may accommodate their different legal and cultural backgrounds.

The most important and significant issue to consider is enforcement, i.e. enforcement of the settlement reached or the remedy obtained. A dispute resolved amicably should be recorded precisely in a settlement agreement which itself provides a mechanism for dispute resolution in the event that a party deviates from the settlement reached or does not comply with its obligations under the settlement agreement.

A final and binding decision obtained from an arbitral tribunal or a court must be enforceable in the event that the losing party refuses to comply with the decision. An arbitral award obtained in a domestic arbitration is usually enforceable under the relevant legislation. For example, an award issued by a tribunal in a domestic arbitration, the seat of which is in Sydney, is enforceable under section 35 of the Commercial Arbitration Act 2010 (NSW).

An arbitral award issued in an international arbitration may be enforceable in any of the 149 States that are parties to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (New York Convention), provided that the award was made in a State that is party to the New York Convention. Enforcement of an award under the New York Convention is a relatively straight forward process simply requiring the filing of the award and the underlying arbitration agreement with the enforcing court. Whilst enforcement may be challenged on limited procedural grounds or because the dispute was not arbitrable or the award is against public policy, it is difficult to succeed in such a challenge. The award may then be enforced and executed as a judgment of the enforcing court.

There is no equivalent mechanism for the enforcement of court judgments. The Hague Convention on the Recognition and Enforcement of Foreign Judgments in Civil and Commercial Matters 1971 (Hague Convention) has few Contracting States. Parties seeking enforcement of a

foreign judgment must rely on reciprocal arrangements between the relevant States or the national law of the State where enforcement is sought. There may be no reciprocal arrangements or it may be difficult to enforce under the relevant national law.

Australian court judgments are enforceable in a number of jurisdictions such as the UK, France, Switzerland and Japan as well as some Commonwealth countries, such as New Zealand and Singapore. Enforcement in Hong Kong, however, may not be straightforward. It may be even more difficult in the US, China, Indonesia, Brazil and the UAE, for example.

### **Dispute resolution clauses: practical tips for drafting**

Careful consideration must be given to drafting a multi-tiered dispute resolution clause. The parties need to consider the options to include, how the parties move through those options and ensure that there is no inconsistencies between the options chosen. For example, there is no need for a jurisdiction clause if the parties have included a dispute resolution clause that refers disputes to arbitration.

Practical tips for drafting a clause providing for negotiations, mediation, expert determination, arbitration or litigation are provided below.

### **Negotiations**

An agreement to negotiate in good faith is in general not enforceable but may be enforceable in the context of a dispute resolution clause as long as the clause is sufficiently certain. For example, a clause to "meet and undertake genuine and good faith negotiations with a view to resolving the dispute or difference" has been upheld by the courts.

The parties may agree on one or more rounds of negotiations. The first round may be between the managers or persons involved in the transaction or project. The second round may see the dispute escalated to a more senior or executive level.

Most importantly, the clause should include time limits for the negotiations to avoid protracted negotiations that do no more than delay the resolution of the dispute. The time limits enable the parties to move to the next stage if an amicable resolution cannot be reached. The parties can always agree to extend the time limits if progress is being made or a settlement is imminent. However, a negotiations clause should provide for no more than negotiation of the dispute and the relevant time limits. It should not, for example, provide for negotiation of how to resolve the dispute as in *WTE Co-Generation v RCR Energy Pty Ltd*. In that case, the clause provided: "In the event the parties have not resolved the dispute then within a further 7 days a senior executive representing each of the parties must meet to attempt to resolve the dispute or agree on methods of doing so." (emphasis added)

The court held that as dispute resolution process was uncertain, the clause was unenforceable. The uncertainty arose from the fact that the clause did not stipulate with sufficient clarity the specific process that the senior representatives were required to follow in order to resolve the dispute beyond the reference to a meeting. It was simply an agreement to agree on the process to be adopted and thus unenforceable.

### **Mediation**

Mediation is a popular form of dispute resolution in Australia and is increasingly becoming

popular in the Asia-Pacific region. Even if the parties have not included mediation in their agreement, they may agree to do so subsequently or the courts will often refer the parties to mediation before progressing court proceedings.

Mediation is a non-binding and voluntary process, unless it has been compelled by the courts. Mediation is facilitated by an independent third party who will consider the positions of the parties and try to encourage the parties to find appropriate terms for settling the dispute.

A mediation clause must include certain elements for it to be enforceable. The clause must provide for the appointment of the mediator, whether that be by agreement of the parties or by a third party if such agreement cannot be reached, and for the mediator's remuneration, which is usually shared by the parties. It must also provide for the process of the mediation or refer to mediation rules, such as the ACICA Mediation Rules or the ICC Mediation Rules, that set out the process. If any further agreement is required at any stage and such agreement cannot be reached, then the clause may be uncertain and unenforceable. Finally the clause should operate as a condition precedent before the parties move to the next stage, i.e. arbitration or litigation.

### **Expert determination**

Expert determination may be suitable for technical or construction issues or valuation issues that need to be resolved quickly, particularly during construction or performance of a contract. It may also be appropriate for disputes of above or below a certain amount.

The first issue to consider in drafting an expert determination clause is the issues that are to be carved out for expert determination. Those issues could be defined by their nature, such as certain technical or construction issues, or by their value, such as issues below a certain amount. Clear and mandatory language should be used to ensure that those issues are to be referred to expert determination and not arbitration or litigation if that is the parties' intention.

The importance of the language used in carving out issues for expert determination is illustrated by *Plenary Research Pty Ltd v Biosciences Research Centre Pty Ltd*. In that case, Plenary had agreed to design, construct and operate a biosciences research facility. Various disputes arose, including a dispute about Plenary's claims for extension of time (EOT). The contract provided for different forms of dispute resolution. Clause 26.16 provided that EOT claims that had been rejected by the Project Director may be referred to expert determination. Clauses 50 to 53 then set out the general dispute resolution clause providing for senior negotiations, expert determination or accelerated dispute resolution and arbitration. Plenary argued that the various claims, including the EOT claims, should be referred to arbitration under clause 53. Bioscience sought a declaration from the court that the EOT claims should be referred to expert determination under clause 26.16.

Both the trial judge and the Victorian Court of Appeal agreed that the dispute should be referred to expert determination. The real issue was the use of the word "may" in clause 26.16, i.e. EOT claims "may" be referred to expert determination. The use of the word "may" indicated that it was not obligatory to refer EOT claims to expert determination. If an EOT claim was not referred to expert determination then the decision of the Project Director would remain in place. The arbitration clause did not operate as a default provision. Hence, the only form of dispute

resolution for EOT claims was expert determination under clause 26.16. That clause gave the parties the opportunity to resolve disputes through an accelerated process without expensive and prolonged litigation or arbitration proceedings.

This issue could have been avoided if the parties had either used mandatory language in clause 26.16 to carve out EOT claims by stating that such claims "are" or "must" be referred to expert determination. Alternatively, clauses 50-53 could have cross-referred to clause 26.16 and/or vice versa to clarify the inter-relationship between the different dispute resolution processes in the contract.

Second, the clause must specify the process for the appointment of the expert. As with the mediator, this may be by agreement of the parties or by a third party if the parties cannot reach agreement within appropriate time frames for the appointment process. The type of expert or the specific qualifications or experience of the expert should be indicated.

Third, the clause should stipulate how the process is to be conducted by, for example, stating that the expert is to act as an expert and not an arbitrator, the parties are to provide submissions and evidence to the expert and the other side and that the expert has a general discretion to determine the process as appropriate.

Fourth, the clause should specify that the expert is to issue a written decision within a certain time frame and whether or not that decision is binding or non-binding. If it is binding then there is no appeal of that decision (unless the parties have agreed otherwise). If it is not binding, then the issue may be referred to arbitration or litigation as agreed by the parties. If the expert is to determine an amount to be paid by one of the parties, then the clause may stipulate the time period for such payment and the interest that may be applicable if payment is not made. Finally, the clause should provide that the costs of the expert are to be shared by the parties unless the expert determines otherwise.

### **Arbitration**

Arbitration may be suitable for disputes between parties of different nationalities (international arbitration) or even between two Australian parties (domestic arbitration). Whilst enforcement of the award is the key consideration for international arbitrations, the ability to choose the arbitrators and a process that is informal and flexible (and sometimes more time and cost effective) may be reasons for referring disputes to arbitration in both an international and domestic context. The restricted mechanism for challenging an award (or appealing a domestic award if the parties have agreed to do so) may also be preferred over endless rounds of appeals in the courts.

The arbitration clause should be kept simple. Many arbitral institutions, such as the Australian Centre for International Commercial Arbitration (ACICA), the Singapore International Arbitration Centre (SIAC) and the International Chamber of Commerce (ICC) have recommended clauses that include all the necessary elements.

An arbitration clause should define broadly the disputes that are to be referred to arbitration to include non-contractual disputes arising out of tort or statute or another cause of action thereby

ensuring that all claims are heard in one forum. The definition should also include disputes relating to the validity, legality or termination of the underlying contract.

The arbitration clause should also specify the following key elements:

- (a) the arbitral rules to be applied, whether they be the rules of an institution such as ACICA, SIAC or the ICC, or ad hoc rules such as the UNCITRAL Arbitration Rules;
- (b) the number of arbitrators to be appointed, whether it be one or three, and the process for that appointment. If the UNCITRAL Arbitration Rules are to apply, then the appointing authority must be specified;
- (c) the seat of the arbitration, which should be a place in a State that is a party to the New York Convention; and
- (d) the language of the arbitration, particularly if the languages of the parties are different.

Optional provisions may be included in the arbitration clause such as provisions for the joinder of parties or consolidation of arbitrations if there are multi-parties to the contract or the transaction or project involves multi-contracts. The parties may wish to opt in to some of the provisions in the International Arbitration Act 1975 (Cth), such as sections 23C, 23D, 23E, 23F and 23G which relate to confidentiality. The parties may waive any rights to appeal on a point of law or to refer a preliminary point of law to the courts, such as that provided in section 69 of the English Arbitration Act 1996.

Finally, if the parties have agreed to refer disputes to arbitration, then any jurisdiction clause in the agreement should be deleted or removed. There is no need to submit to the jurisdiction of the courts for the purpose of resolving disputes if the parties have agreed to arbitration.

Whilst the parties may agree to keep open the "option" to refer the dispute to litigation during the early stages of the arbitration (for example, before the response to the notice of arbitration is filed), careful consideration should be given to such clauses. Optional clauses are not enforceable in some jurisdictions, such as Russia or China.

More importantly, the parties should not attempt to split different disputes between arbitration and litigation. Such a clause is unlikely to be enforceable. For example, in *Lysaght Building Solutions Pty Ltd v Blanalko Pty Limited* [No. 3], the parties had agreed to refer disputes to arbitration except for claims for payment due under the contract. Payment claims could be referred to the courts for summary judgment. Lysaght commenced court proceedings seeking summary judgment for various progress payment claims. Blanalko filed a defence denying liability and issued a counterclaim for breach of contract and sought summary judgment for payments it claimed it was owed. Lysaght then applied for a stay of the court proceedings under section 8 of the Commercial Arbitration Act 2010 (Vic). Section 8 requires the court to refer the parties to arbitration if there is an arbitration clause. A stay was granted with respect to disputes that did not fall within the carve out for payment claims. There is often a difficulty in determining what disputes should be carved out for payment claims as often claims for payment arise because of other breaches of the contract and as a result cannot be resolved summarily.

## **Litigation**

The parties may agree to refer disputes to the courts. For many disputes, the courts will be the

most appropriate forum. The Australian courts are, in general, efficient and cost-effective. The courts of other States may not be so efficient or cost effective or may not even be independent. The ability to enforce an Australian court judgment overseas or a foreign judgment in Australia should also be considered.

A jurisdiction clause may refer disputes to the exclusive or non-exclusive jurisdiction of the courts. The parties may agree to waive any forum non-conveniens arguments. It may also be necessary to include a service of process agent if one party is outside the jurisdiction.

Most importantly, there is no need to include a jurisdiction clause if the parties have agreed to refer disputes to arbitration.

### **Conclusion**

In conclusion, careful consideration must be given to drafting dispute resolution clauses. The most appropriate options must first be taken into account. Having decided on those options, the specific language of the clause must be drafted carefully to ensure the clause is certain and enforceable. Taking the additional care and attention at the time of negotiations may facilitate a speedy resolution of disputes when they arise and prevent or avoid an unnecessary dispute about the scope and meaning of the dispute resolution clause itself. At the end of the day, it is vital to ensure that the remedy obtained is enforceable or the time and expense of the parties will have been futile.