CHAPTER 3

Multi-tier dispute resolution clauses in construction contracts

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Introduction

3.1 Disputes arising from construction contracts have been a fertile ground for developing novel methods of dispute resolution. This has led to the adoption of clauses that include multiple dispute resolution methods in an attempt to seek to resolve disputes more quickly and efficiently than using the usual methods of arbitration or litigation. It also allows the parties to see whether they can reach a consensual solution before arbitration or litigation. The wholly commendable aim can however create difficulties that render the multi-tier clauses a burden for a claimant and an opportunity to delay resolution of the dispute by a defending party.

3.2 In this chapter the author considers some of the typical issues that arise from these multiple clauses. It is helpful, first, to review two typical clauses found in practice.

Typical multi-tier clauses

3.3 The International Chamber of Commerce (ICC) has a standard clause for use with a Dispute Adjudication Board (DAB) and then arbitration. It provides:

> (a) All disputes arising out of or in connection with the present Contract shall be submitted, in the first instance, to the DAB in accordance with the Rules. For any given dispute, the DAB shall issue a Decision in accordance with the Rules. The DAB shall submit each Decision to ICC for review in accordance with Article 21 of the Rules.
> (b) If any Party fails to comply with a Decision when required to do so pursuant to the Rules, the other Party may refer the failure itself to Arbitration under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules of Arbitration.
> (c) If any Party sends a written notice to the other Party and the DAB expressing its dissatisfaction with a Decision, as provided in the Rules, or if the DAB does not issue the Decision within the time limit provided for in the Rules, or if the DAB is disbanded pursuant to the Rules, the dispute shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules of Arbitration.

3.4 The familiar clause in FIDIC fourth edition is still commonly used. It provides for reference to the Engineer, amicable settlement and arbitration:

> (a) If a dispute of any kind whatsoever arises between the Employer and the Contractor in connection with, or arising out of, the Contract or the execution of the Works . . . shall, in the first place, be referred in writing to the Engineer, with a copy to

the other party. Such reference shall state that it is made pursuant to this Clause. No later than the eighty-fourth day after the day on which he received such reference the Engineer shall give notice of his decision to the Employer and the Contractor. Such decision shall state that it is made pursuant to this Clause.

(b) If either the Employer or the Contractor be dissatisfied with any decision of the Engineer, or if the Engineer fails to give notice of his decision on or before the eighty-fourth day after the day on which he received the reference, then either the Employer or the Contractor may, on or before the seventieth day after the day on which the said period of 84 days expired, as the case may be, give notice to the other party, with a copy for information to the Engineer, of his intention to commence arbitration, as hereinafter provided, as to the matter in dispute. Such notice shall establish the entitlement of the party giving the same to commence arbitration, as hereinafter provided, as to such dispute and, subject to Clause 67.4, no arbitration in respect thereof may be commenced unless such notice is given.

(c) If the Engineer has given notice of his decision as to a matter in dispute to the Employer and the Contractor and no notice of intention to commence arbitration as to such dispute has been given by either the Employer or the Contractor on or before the seventieth day after the day on which the parties received notice as to such decision from the Engineer, the said decision shall become final and binding upon the Employer and the Contractor.

(d) Where notice of intention to commence arbitration as to a dispute has been given in accordance with Sub-Clause 67.1, the parties shall attempt to settle such dispute amicably before the commencement of arbitration. Provided that, unless the parties otherwise agree, arbitration may be commenced on or after the fifty-sixth day after the day on which notice of intention to commence arbitration of such dispute was given, even if no attempt at amicable settlement thereof has been made.

(e) Any dispute in respect of which:
  (i) the decision, if any, of the Engineer has not become final and binding pursuant to Sub-Clause 67.1, and
  (ii) amicable settlement has not been reached within the period stated in Sub-Clause 67.2,

shall be finally settled, unless otherwise specified in the Contract, under the Rules of Conciliation and Arbitration of the International Chamber of Commerce by one or more arbitrators appointed under such Rules.

Problems with multi-tier clauses

3.5 The first problem with such clauses is that they very often require all disputes to pass a number of hurdles before they can be resolved. Often payment disputes arising from a failure to pay may require a shorter route to an award or judgment than a dispute about non-performance and termination. The difficulty is that one multi-tier clause does not fit all disputes. Secondly, multi-tier clauses stem from the wish of commercial people to try to agree resolution methods that allow them to keep control of matters within the area of negotiation and agreement and that provide for quicker and cheaper methods of dispute resolution than arbitration or litigation. Experience shows that, even where multi-tier clauses are not used, parties will generally use negotiation or mediation to seek to resolve their disputes.

3.6 These factors would suggest that multi-tier dispute resolution clauses contain an unnecessary degree of over-elaborate drafting at the time of negotiating the agreement. There are also other problems with such clauses when disputes arise.

3.7 In general, there are three main issues that arise when there are multiple methods of dispute resolution. The first issue is whether the method of dispute resolution is sufficiently defined to give rise to enforceable rights. The second is whether each of the steps in the dispute resolution process is mandatory or voluntary. The third question is whether failure to follow one of the steps precludes a party from proceeding to the next step because the prior steps are conditions precedent. Each of those issues gives a reluctant party, facing a claim, an opportunity to cause delay to the process.

3.8 There is also the opportunity for a party to contend that 'the dispute' has not been referred to the prior method of dispute resolution. It may be alleged that there had been no dispute when the party started the dispute resolution process. Such an argument has been well rehearsed in arbitration and adjudication claims in this jurisdiction but the decision at first instance in *AMEC Civil Engineering v Secretary of State for Transport*,[1] approved on appeal and in *Collins (Contractors) Ltd v Baltic Quay Management (1994) Ltd*,[2] has taken much of the force out of that argument. However, the argument still lives on in multi-tier disputes. Very often the dispute referred to arbitration will have developed since it was referred to the first tier of the dispute resolution process and this then provides a fertile ground for challenge on the basis that the expanded scope of the dispute was not referred to the first stage of the dispute resolution process.

Enforceability of multi-tier clauses

3.9 In England the starting point for considering the enforceability of such clauses is the House of Lords decision in *Walford v Miles*,[3] approving the Court of Appeal decision in *Courtney & Fairbairn v Tolaini Brothers (Hotels) Ltd*[4] and disapproving a dictum of Lord Wright in *Hillas v Arcos*.[5] In that case, it was held that a 'lock out agreement', by which a party agreed to negotiate with one party, was unenforceable as a bare agreement to negotiate. It held that the agreement contained no term as to the duration of the obligation to negotiate and made no provision for a party to terminate the negotiations. It also held that a duty to negotiate in good faith was unworkable in practice and inherently inconsistent with the position of a negotiating party, since while the parties were in negotiation either of them was entitled to break off the negotiations at any time and for any reason.

3.10 In *Petromec Inc v Petroleo Brasileiro SA*[6] the Court of Appeal, whilst holding that it was bound by *Walford v Miles*, considered *obiter* that in the context of a concluded agreement there was no good reason why a limited agreement to negotiate certain aspects should be unenforceable.

3.11 The process of mediation is essentially a process by which the parties seek to negotiate the terms of a settlement agreement with the assistance of a third party. In *Cable & Wireless plc v IBM United Kingdom Ltd*[7] it was held that an agreement to 'attempt in

1 *AMEC Civil Engineering v Secretary of State for Transport* [2004] EWHC 2339 (TCC).
2 *Collins (Contractors) Ltd v Baltic Quay Management (1994) Ltd* [2004] EWCA Civ 1757, [2005] BLR 63.
3 *Walford v Miles* [1992] 2 AC 128 (HL).
4 *Courtney & Fairbairn v Tolaini Brothers (Hotels) Ltd* [1975] 1 WLR 297 (CA).
5 *WN Hillas & Co Ltd v Arcos Ltd* (1932) 147 LT 503 at 515 (HL).
6 *Petromec Inc v Petroleo Brasileiro SA Petrobras (No.3)* [2005] EWCA Civ 891, [2006] 1 Lloyd's Rep 121.
7 *Cable & Wireless plc v IBM United Kingdom Ltd* [2002] EWHC 2059 (Comm), [2002] 2 All ER (Comm) 1041.

good faith to resolve the dispute or claim' was enforceable where the parties agreed to resolve a dispute by alternative dispute resolution by using a procedure recommended by the Centre for Dispute Resolution as this was sufficiently certain to be enforceable. In *Holloway v Chancery Mead Ltd*[8] it was stated that three requirements were necessary for an ADR clause to be effective: the process must be sufficiently certain without the need for agreement before matters could proceed; the administrative process for choosing and paying the person resolving the dispute must be defined and the process or at least the model for the process should be sufficiently certain.

3.12 In *Sulamerica Cia Nacional de Seguros SA v Enesa Engenharia SA*[9] the Court of Appeal considered a mediation clause which provided:

> If any dispute or difference of whatsoever nature arises out of or in connection with this policy including any question regarding its existence, validity or termination, hereafter termed as dispute, the parties undertake that, prior to a reference to arbitration, they will seek to have the dispute resolved amicably by mediation.

3.13 There then followed an arbitration clause in these terms:

> In case the insured and the insurer(s) shall fail to agree as to the amount to be paid under this policy through mediation as above, such dispute shall then be referred to arbitration under ARIAS Arbitration Rules.

3.14 The claimant insurers argued that they had commenced valid arbitration proceedings because the defendant insured had failed or refused to join in a mediation. They also argued that the mediation provision was ineffective to create a binding obligation or to impose a condition on the commencement of arbitration. The insured argued that they were not bound to arbitrate because the right to refer disputes to arbitration arose only after the requirement of mediation had been satisfied.

3.15 The Court of Appeal referred with approval to *Cable & Wireless* and *Holloway* and held that the mediation provision did not set out any defined mediation process nor did it refer to the procedure of a specific mediation provider. The first paragraph contained merely an undertaking to seek to have the dispute resolved amicably by mediation and no provision was made for the process by which that was to be undertaken. The clause was not apt to create an obligation to commence or participate in a mediation process. It might be said that it imposed on any party contemplating arbitration an obligation to invite the other to join in an ad hoc mediation but the content of even such a limited obligation was so uncertain as to render it impossible to enforce in the absence of some defined mediation process. The mediation provision was therefore incapable of giving rise to a binding obligation of any kind.

3.16 In *Wah v Grant Thornton*[10] the court had to consider a multi-tier clause that provided as follows, with a standard arbitration clause also being included in the agreement:

> (a) Any dispute or difference as described in Section 14.2 shall in the first instance be referred to the Chief Executive in an attempt to settle such dispute or difference by amicable conciliation

8 *Holloway v Chancery Mead Ltd* [2007] EWHC 2495 (TCC), [2008] 1 All ER (Comm) 653.
9 *Sulamérica Cia Nacional de Seguros SA v Enesa Engenharia SA* [2012] EWCA Civ 638, [2013] 1 WLR 102.
10 *Wah v Grant Thornton International Ltd* [2012] EWHC 3198 (Ch).

> or an informal nature. The conciliation provided for in this Section 14.3 shall be applicable notwithstanding that GTIL may be a party to the dispute or difference in question.
>
> The Chief Executive shall attempt to resolve the dispute or difference in an amicable fashion. Any party may submit a request for such conciliation regarding any such dispute or difference, and the Chief Executive shall have up to one (1) month after receipt of such request to attempt to resolve it.
>
> If the dispute or difference shall not have been resolved within one (1) month following submissions to the Chief Executive, it shall be referred to a Panel of three (3) members of the Board to be selected by the Board, none of whom shall be associated with or in any other way related to the Member Firm or Member Firms who are parties to the dispute or difference. The Panel shall have up to one (1) month to attempt to resolve the dispute or difference.
>
> Until the earlier of (i) such date as the Panel shall determine that it cannot resolve the dispute or difference, or (ii) the date one (1) month after the request for conciliation of the dispute or difference has been referred to it, no party may commence any arbitration procedures in accordance with this Agreement.

3.17 The defendants started arbitration but the claimants alleged that the arbitral tribunal had no jurisdiction because the prior steps, which were a condition precedent, had not been followed. The tribunal held that it did have jurisdiction because the steps in the agreement were not sufficiently precise or certain to be contractually binding; alternatively, that they had not been intended to prevent a reference to arbitration.

3.18 It was held that the relevant test was whether obligations imposed were sufficiently clear and certain to be given legal effect. In the context of an obligation to attempt to resolve a dispute before referring it to arbitration, the test was whether the provision provided, without the need for further agreement: (1) a sufficiently certain and unequivocal commitment to commence a process; (2) a means of discerning the steps each party was required to take to start the process; (3) sufficient clarity and definition to enable the court to make an objective determination of the minimum participatory requirements for each party; (4) an indication of how the process would be exhausted or properly terminable without breach.

3.19 At [57] it was said

> Agreements to agree and agreements to negotiate in good faith, without more, must be taken to be unenforceable: good faith is too open-ended a concept or criterion to provide a sufficient definition of what such an agreement must as a minimum involve and when it can objectively be determined to be properly concluded. That appears to be so even if the provision for agreement is one of many provisions in an otherwise binding legal contract, with an exception where the provision in question can be construed as a commitment to agree a fair and reasonable price.

3.20 On the facts, it was held that the relevant provisions of the agreement were too equivocal and nebulous in communicating the parties' respective obligations to be given legal effect as an enforceable condition precedent to arbitration. The omission to give any guidance as to the quality or nature of the attempts to be made to resolve a dispute rendered the court unable to determine or direct compliance with the agreement.

3.21 However, in *Emirates Trading Agency LLC v Prime Mineral Exports Pte Ltd*[11] there was a clause which provided that

11 *Emirates Trading Agency LLC v Prime Mineral Exports Pte Ltd* [2014] EWHC 2104 (Comm), [2015] 1 WLR 1145.

> parties shall first seek to resolve the dispute or claim by friendly discussion . . . If no solution can be arrived at between the parties for a continuous period of four weeks then the non-defaulting party can invoke the arbitration clause and refer the dispute to arbitration.

There was then a provision that all disputes arising out of the contract 'shall finally be resolved by arbitration. A party referred a dispute to arbitration. The arbitrators determined that they had substantive jurisdiction to determine the dispute because the clause requiring friendly discussion was not an enforceable obligation and in any event the parties had complied with it.

3.22 It was held that the dispute resolution clause was enforceable. It was contained in an enforceable contract that required the parties to seek to resolve the dispute by friendly discussions in good faith and within a specified period of time before the dispute might be referred to arbitration. The agreement to negotiate was complete as no essential term was lacking and it had an identifiable standard of fair, honest and genuine discussions aimed at resolving the dispute and so was not uncertain. It was also held that enforcement was in the public interest since commercial parties expected the court to enforce obligations that they had freely undertaken and the object of the clause was to avoid what might otherwise be an expensive and time-consuming arbitration. The fact that such an agreement permitted discussion and consideration of the parties' wider commercial interests and was not limited by faithfulness and fidelity to the existing bargain did not render it unenforceable. Further, on the facts, there had been friendly discussions between the parties, in good faith, seeking to resolve the matter so that the condition precedent had been met. The dictum in *Wah v Grant Thornton* was not applied

3.23 Rather, support for the decision was derived from the judgment of the New South Wales Court of Appeal in *United Group Rail Services Ltd v Rail Corpn New South Wales*[12] where a contract for rolling stock contained a dispute resolution clause that provided that the parties should 'meet and undertake genuine and good faith negotiation with a view to resolving the dispute' and that, failing such resolution, the dispute could be arbitrated. In holding that the obligation to negotiate was enforceable, Allsop P carried out an extensive examination of English and Australian authorities. Whilst he accepted that an agreement to agree was unenforceable, he considered that it did not follow that an agreement to undertake negotiations in good faith to settle a dispute arising under a contract was unenforceable.

3.24 Reference was also made to what Allsop P said about good faith, that in the field of dispute resolution clauses the court ought not to regard an obligation to seek to resolve a dispute in good faith as inherently inconsistent with the position of a negotiating party. It was not inconsistent where there is a material, voluntarily accepted, restraint on the parties' freedom of action, namely, a promise to seek to resolve a dispute by friendly discussions in good faith.

3.25 Further, reliance was placed on decisions from Singapore. In *International Research Corpn plc v Lufthansa Systems Asia Pacific Pte* Ltd[13] the High Court of Singapore (upheld on appeal on this point) held that a clause that referred to arbitration disputes 'which cannot be settled by mediation' provided a condition precedent to arbitration that was not too uncertain to be enforceable. In coming to that decision, the judge had relied on the decision of the Singapore Court of Appeal in *HSBC Institutional Trust*

12 *United Group Rail Services Ltd v Rail Corpn New South Wales* (2009) 127 Con LR 202.
13 *International Research Corpn plc v Lufthansa Systems Asia Pacific Pte Ltd* [2013] 1 Lloyd's Rep 24.

Services (Singapore) Ltd v Toshin Development Singapore Pte Ltd,[14] which concerned a contract that obliged parties to endeavour in good faith to agree a new rent. *Walford* was distinguished on the basis that that case concerned a standalone agreement where there was no other overarching contractual framework that governed the parties' relationship.

3.26 Finally, reference was made to the decision of the ICSID Tribunal in *Tulip Real Estate Investment and Development Netherlands B*V *v Republic of Turkey*[15] where obligations to seek to resolve disputes by negotiation in good faith were held to be binding and enforceable.

3.27 This led the judge in *Emirates Trading* to conclude:

> I am not bound by authority to hold that a dispute resolution clause in an existing and enforceable contract which requires the parties to seek to resolve a dispute by friendly discussions in good faith and within a limited period of time before the dispute may be referred to arbitration is unenforceable. In my judgment such an agreement is enforceable.[16]

3.28 In the Swiss Federal Tribunal decision in *X GmbH v Y Sarl*[17] the court had to consider a preliminary objection that an arbitral tribunal, which had made an award on a dispute under a sales contract, did not have jurisdiction because it had disregarded a mandatory and preliminary contractual requirement to resort to an expert and to mediation. In that case, there were dispute resolution clauses in the sales contract which provided, first, 'In case of dispute as to the conformity or none-conformity of the supplies and services the Buyer and the Supplier must have recourse to a neutral expert before submitting the dispute to an arbitral tribunal.' Secondly, it stated 'In case of a dispute as to the interpretation or the performance of this contract an amicable settlement shall first be sought by the parties.' Finally, it provided that 'The possible disputes which may arise as to the interpretation or the performance of the provisions of this Procurement shall be submitted, after an attempt at conciliation fails, to an arbitral tribunal with no recourse to judiciary courts.'

3.29 The court considered the reference to 'an attempt at conciliation' and noted the absence of any specific provision in the clause that showed that this was a necessary step for the admissibility of arbitral proceedings and the fact that the clause did not describe the conciliation proceedings in any greater details. In holding that conciliation was therefore not a mandatory step prior to arbitration, the court said:

> Thus by reading the clause at hand, one does not know exactly what that tentative conciliation would have consisted of, assuming that the Parties would have given the same meaning to such a step, neither is it known if it required the intervention of a mediator or not, or even if it had to be initiated within a certain time limit. Such lack of precision doubtlessly does not argue in favour of the mandatory nature of the conciliation to be attempted.

3.30 In the French Cour de Cassation decision in *Medissimo v Logica*[18] they considered a multi-tier clause in an IT outsourcing contract. The court held that an agreement to attempt

14 *HSBC Institutional Trust Services (Singapore) Ltd v Toshin Development Singapore Pte Ltd* [2012] 4 SLR 378.

15 *Tulip Real Estate Investment and Development Netherlands B*V *v Republic of Turkey*, ICSID Case No ARB/11/28, paras 56–72.

16 *Emirates Trading Agency LLC v Prime Mineral Exports Pte Ltd* [2014] EWHC 2104 (Comm), [2015] 1 WLR 1145, para 64.

17 *X GmbH v Y Sarl*, 4A 46/2011.

18 *Medissimo v Logica,* 29 April 2014, No 12–27.004.

to resolve a dispute without any particular conditions as to how that was implemented was not a condition precedent to court proceedings. It referred to the earlier decision of the Cour de Cassation in *Poiré v Tripier*,[19] which held that a clause that required a mandatory conciliation procedure was lawful and binding and that a claim brought by a party without first complying with that clause would be inadmissible.

Conclusion

3.31 It can be seen that in different jurisdictions multi-tier clauses raise similar issues when they come to be considered in any arbitration or court proceedings. The obligation on parties to negotiate, whether to do so expressly or impliedly 'in good faith' appears to be gaining ground in common law jurisdiction, with the principle established by *Walford v Miles* being limited to a free-standing agreement to agree rather than an agreement to negotiate in the context of disputes arising out of obligations under an existing contract.

3.32 The decisions show that to be enforceable there has to be some certainty in the definition of the obligations that a party has to undertake as a stage in the tiered process. Thus an 'attempt at conciliation' without any definition of the process or duration of the obligation did not suffice, whilst reference to a procedure administered by a third party ADR body would suffice.

3.33 If there is a multi-tier clause then, as stated by Lord Mustill in *Channel Tunnel Group v Balfour Beatty*,[20] the court has a power to stay proceedings under its inherent jurisdiction when they are commenced without complying with enforceable, mandatory prior tiers of dispute resolution that are conditions precedent to the ability to commence arbitration or court proceedings. This would clearly be the remedy if court proceedings were brought in breach of the agreement or if arbitration proceedings were commenced in those circumstances. Otherwise it would be at the stage of enforcement of an arbitration award that the failure to comply would arise. It is possible that damages for failure to comply with the multi-tier clause might be sought but that would be unlikely to be a practical remedy.

3.34 It follows that the important lesson is that, if a multi-tier clause is being drafted, the drafter has to make sure that the tiers are defined in such a way as to make them enforceable, mandatory, and conditions precedent. The alternative is to leave the tiers to be developed at the time the dispute arises. The problem then is that willingness to agree is often less likely at that stage.

19 *Poiré v Tripier*, JurisData No 2003–017812.

20 *Channel Tunnel Group v Balfour Beatty* [1993] AC 334 (HL).