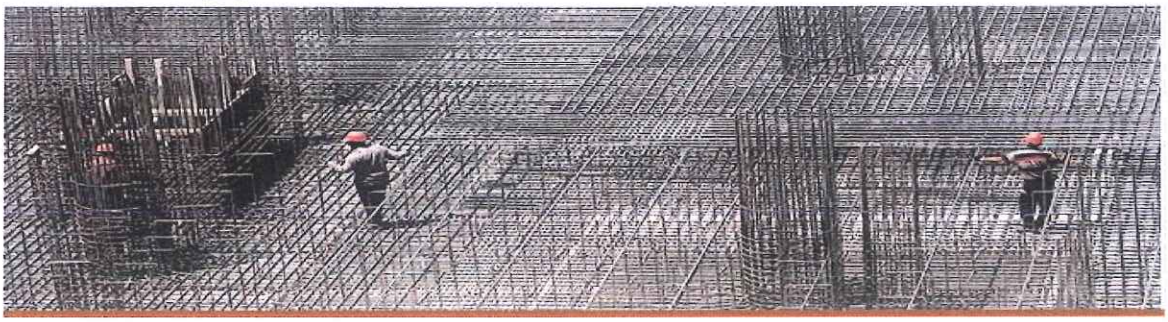
Comments by Paul Taylor, Construction & Energy consultant at Payne Hicks Beach
feature online at CDR News first published on 29 September 2014



Laying the foundations

Ben Rigby - 26 September, 2014

An English judgment on escalating dispute resolution clauses markedly extends the position on the enforceability of such clauses.

The judgment, handed down in July by Mr Justice Teare in Emirates Trading Agency LLC v Prime Mineral Exports Private Limited , ruled on the issue of escalating dispute resolution clauses.
It has extended the position on the enforceability of such clauses in England, having adopted Australian and Singaporean authority.
Addleshaw Goddard acted on behalf of the defendants, led by partner Simon Kamstra . Clyde & Co acted for the claimants, who instructed Vasanti Selvaratnam QC of Stone Chambers .
The use of dispute resolution clauses is common in construction claims. Adam Constable QC of Keating Chambers says that parties commonly agree some form of more informal dispute resolution prior to commencing formal proceedings. This, he says, can take the shape of senior management-level discussions, adjudication or mediation.
"Such clauses are designed to require that parties to a contract first attempt to resolve disputes by negotiation or agreement prior to proceeding to arbitration or litigation," says Mark Farquhar of K&L Gates in Melbourne.
David Brynmor Thomas of 39 Essex Street , who acted as counsel in the case for the defendants, Prime Mineral Exports , agrees such a general obligation "is enforced already by other sophisticated common law jurisdictions, such as Singapore and New South Wales".
Reviewing the judgment for CDR , Constable says the contract held a requirement to settle the dispute, via a multi-tiered dispute resolution clause, requiring 'friendly negotiations', with arbitration commencing only after a continuous period of four weeks during which no solution was found. Constable says the trial judge "rightly identified that authorities he had reviewed suggested that, in English law as it is presently understood, such an obligation is unenforceable".
Teare J wrote: "[I]n recent years, following the frequent insertion in commercial contracts of mediation or ADR provisions, judges have stated that mere agreements to negotiate are unenforceable; see, for example, Colman J in Cable & Wireless v IBM (2002) and Hildyard J in Wah v Grant Thornton (2012)".
"This is generally because of a perceived lack of certainty," Constable says. "If it is not possible to identify the basis upon which it could be said that one party is in breach, how can the clause be certain enough to create a binding agreement?"
In reaching his conclusion in the Emirates case, the judge departed from settled English law, and instead applied an Australian approach, preferring to enforce the terms of an agreement between parties, particularly in a commercial context.

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A STARK CHANGE IN POSITION

Brynmor Thomas says the Emirates judgment was a marked extension of the approach taken by Coleman J in Cable & Wireless , where that judge found that mediation clauses were enforceable but commented that agreements to negotiate were not.

Teare J departed from that authority, in particular distinguishing the previous English case of Walford v Miles , by reference to the New South Wales authority United Group Rail Services v Rail Corporation New South Wales (2009) and the Singaporean authority of Research Corp PLC v Lufthansa Systems Asia Pacific Pte Ltd (2012).

Teare J also relied on academic authority for his ruling, citing Lord Steyn 's lecture in 1997 – ' Lecture on Contract Law: fulfilling the reasonable expectations of honest men ' – in which that judge, a member of the UK's then-highest court, criticised the judgment in Walford v Miles . In doing so, says Brynmor Thomas, the judgment brings England in line with the approach being taken in other jurisdictions.

The judge's reasoning was that, although as a matter of evidence there were grey areas where it is difficult to establish a breach, there were examples where non-compliance is obvious – "for example, where one party refuses to engage at all", notes Constable. Provided compliance with the dispute resolution clause was able to be measured properly, such agreements could be enforceable, he adds.

"The agreement is not incomplete; no term is missing," wrote Teare J. "Nor is it uncertain; an obligation to seek to resolve a dispute by friendly discussions in good faith has an identifiable standard, namely, fair, honest and genuine discussions aimed at resolving a dispute."

He added: "Difficulty of proving a breach in some cases should not be confused with a suggestion that the clause lacks certainty".

In a key passage, he ruled: "Enforcement of such an agreement when found as part of a dispute resolution clause is in the public interest, first, because commercial men expect the court to enforce obligations which they have freely undertaken and, second, because the object of the agreement is to avoid what might otherwise be an expensive and time consuming arbitration".

Brynmor Thomas agrees, saying, that "there might still be problems with clauses that do not have any time reference to them", but compliance could be tested "if a clause requires parties at least to meet within a specified period, to see if they might resolve their dispute through discussions".

He adds: "Although we have tended to discount such obligations in English law, almost as a matter of course, once you appreciate that they can have content, so compliance can be tested, they make perfectly good commercial sense. That is why commercial people insert them in their agreements".

AUSTRALIAN AUTHORITY SUPPORTS CHANGE

Constable notes that Teare J relied heavily upon the reasoning in United Group Rail Services , an Australian authority which held the enforcement of these clauses was in the public interest. Geoff Hansen , a Herbert Smith Freehills partner in Melbourne, says that escalating dispute resolution clauses are commonly used in Australia and appear in most construction contracts in one form or another.

In United , the court found that a provision in a multi-tier dispute resolution clause referring certain disputes to negotiation between senior representatives required to "meet and undertake genuine and good faith negotiations with a view to resolving the dispute" was valid and enforceable.

The clause required such a meeting within 14 days as a condition precedent to party arbitration. In order to determine compliance, the court looked to whether the parties had brought an honest and genuine approach to settling the contractual dispute, and whether they had given fidelity to the existing bargain.

Nicola Nygh , a special counsel with Allens in Sydney, agrees that the decision in Emirates was "consistent with the approach of Australian courts to interpret dispute resolution clauses robustly and to avoid a narrow or pedantic approach in favour of a commercially sensible construction". The approach followed in United was recently discussed by Justice Vickery in the Victorian case of WTE Co-Generation v RCR Energy Pty Ltd (2013), says Georgie Farrant of Baker & McKenzie 's disputes team in Sydney.

Although Vickery J applied the reasoning of the NSW Court from United , even articulating 11 principles for consideration, he ultimately distinguished the case and ruled that the clause in question contained an uncertain process and was unenforceable. The clause before the Victorian court stated that "each of the parties must meet to attempt to resolve the dispute or to agree on methods of doing so".

Vickery J ruled that: "The sub clause amounts to an agreement to agree on the process of dispute resolution to be employed and is not therefore enforceable due to this inherent uncertainty". In comparison, the clause before the NSW court was considered enforceable.

Farquhar flags another recent decision, by Chief Justice Martin of the Supreme Court of Western Australia in Pipeline Services WA v Atco Gas Australia (2014), who noted that "the tendency of recent authorities is strongly in favour of adopting a construction of such provisions which provides them with enforceable content".

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GOOD FAITH

One aspect of the decision in Emirates was the judge's interpretation of the clause seeking to resolve disputes by friendly discussions. Teare J held that obligation "must import an obligation to seek to do so in good faith. In traditional terms such an obligation goes without saying and is necessary to give business efficacy to the contract. In modern terms that is what the contract would be reasonably understood to mean".

Nygh says that Australian courts have tended to interpret such 'good faith' obligations to be enforceable, as reflected in the decision by both the trial judge and the NSW Court of Appeal in United .

Hansen confirms there are sound public policy reasons for doing so, "consistent with the promotion of efficient commercial dispute resolution". Nygh agrees, saying "it reflects commercial expectations that parties to a dispute will negotiate honestly and genuinely to resolve the dispute and thereby try to avoid the financial and time costs of court or arbitration proceedings".

Jennifer Galatas , a senior associate at Herbert Smith Freehills nevertheless warns that findings on good faith "may lead to increased disputes as parties seek to test the content of the good faith standard", raising the possibility of tactical challenges.

Equally, John Kelly , a partner at K&L Gates in Melbourne, suggests that "while the trend in Australia suggests that in time a term of good faith may be implied into agreements to negotiate, this is not yet the settled position". Emirates , he says, "takes the position a step further and it will be interesting to see the attitude of Australian courts in due course". Kelly says, however, that the enforceability of clauses requiring 'good faith' settlement is a relatively recent development.

"Prior to United there had been decisions which found that clauses requiring parties to negotiate in good faith were unenforceable for lack of certainty on the basis that a court could not determine whether a party has acted in good faith," he says.

Galatas adds that any risks can be mitigated by parties paying close attention to the drafting of their dispute resolution clauses. This, she says, "reinforces the importance of negotiation processes being prescribed and there being a clearly identifiable point at which negotiation concludes so [disputes] proceed to the next phase if necessary".

HONEST ENDEAVOURS GIVEN MEANING

For her part, Farrant says that following recent extensive revision of the commonly used Standards Australia Conditions of Contract terms, further amendments to Australian clauses may be needed following the WTE case, because the clause in that case was a slightly amended version of the Australian Standard.

Until the law is more settled, she says, "parties wishing to include pre-conditions in their contracts should seek to ensure that those clauses are as clear as possible".

Brynmor Thomas says that, from an English perspective, "some people still make the error of thinking that express 'good faith' provisions in contracts will not be given meaning by the courts".

He adds: "English law can deal perfectly properly with those provisions and there is no reason it will not deal properly with promises such as this, into which a good faith obligation is, in effect, implied by law".

Paul Taylor , a consultant at Payne Hicks Beach , agrees, saying parties to a dispute should be under a clear duty, contractually, to commit themselves to honest endeavours to settle – avoiding fishing expeditions or simply cynically going through the motions.

Brynmor Thomas would, however, have "concerns if the court started to look behind the fact that discussions were held about the dispute, at the content of those discussions, so as to test 'good faith'".

He concludes: "If parties remember they may be held to their bargain, and discuss disputes once they have arisen, before starting proceedings, I don't anticipate clauses like this throwing up undue problems in future".

Constable adds that the "requirements of honesty and genuineness in approaching negotiations contain elements of subjectivity, but are not nebulous; and [such requirements] do provide sufficient constraint to a party to be enforceable".

He says: "Undoubtedly, each clause will continue to turn on its own construction and parties should be aware that the more they agree to some sort of framework into which negotiations should sit, the more likely it is that the clause will be upheld by the court".

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