

# 'Gaps' can end in tears

Multi-tiered dispute resolution clauses can save parties time and money but, as **Elizabeth Kantor** and **Philip Parrott** of **Herbert Smith Freehills** warn, there are potential pitfalls to watch out for.

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## KEY POINTS

- Multi-tiered dispute resolution clauses provide for parties to resolve disputes using different methods in sequence and usually include at least one method of alternative dispute resolution before a final decision by the courts or an arbitral tribunal
- They can allow parties to resolve disputes in a less formal and adversarial setting, and can save time and money
- They should be drafted and negotiated with care, as there are a number of pitfalls for the unwary party
- In particular, parties should carefully consider the project and the disputes likely to arise to ensure that the clause addresses the specific needs of the project
- Further, these clauses should be sufficiently clearly worded to avoid procedural arguments

A multi-tiered dispute resolution clause (also known as an 'escalation clause') is a clause in a contract incorporating several different stages or methods for parties to resolve (or attempt to resolve) disputes. It either requires or permits parties to use a form of alternative dispute resolution (for example, negotiation, mediation, adjudication, expert determination or dispute board) before providing for a binding resolution by litigation or arbitration. Typically the first stage is negotiation, whether formal or informal.

There are a number of reasons why parties may wish to include a multi-tiered dispute resolution clause in their contracts:

- ◆ Opportunity to resolve disputes in less formal and adversarial settings.

- ◆ Preservation of business/commercial relationship between them.
- ◆ Saving of time and money by resolving disputes without recourse to litigation or arbitration.
- ◆ Tailored to be suitable for the project and the types of disputes which may arise.

Some of the best multi-tiered dispute resolution clauses in construction projects make use of dispute boards (boards of one or more independent professionals who review the facts and either make recommendations or binding decisions). It has been said that in the early 2000s around 97 per cent of disputes referred to dispute boards were finally resolved by these boards without recourse to litigation. This still rings true today.

## Dispute boards

Parties may consider including a dispute board as one of the stages for the following reasons:

- ◆ Both employers and contractors must participate and engage in the process.
- ◆ From a contractor's perspective, it can ensure prompt payment of outstanding moneys so that the project can be completed on time.
- ◆ They allow contemporaneous resolution of disputes (whereas often court trials and arbitration hearings rely on evidence produced some time after the event).
- ◆ Used effectively, they minimise distraction and can keep the project moving.
- ◆ Parties can get a 'sense' check of arguments before taking them further (ie to litigation or arbitration).

## Common clauses in a construction context

A good example is cl 20 of the FIDIC Red, Yellow and Silver Books (1999 editions). This clause provides for a dispute resolution procedure involving the following stages: (a) submitting a claim to the engineer who makes a determination; (b) referring a dispute to the DAB (dispute

adjudication board) for a decision; (c) giving a notice of dissatisfaction in respect of the DAB's decision; (d) amicable settlement; and (e) arbitration.

The UK's HM Treasury included guidance on a multi-tiered dispute resolution clause in the standard wording and guidance it issued for public sector bodies to use when drafting PFI contracts. This was included in the Standardisation of PFI Contracts (SoPC), Version 4 (March 2007).

It has also been included in HM Treasury's draft Standardisation of PF2 Contracts document, issued in December 2012.

Both provide for a three stage dispute resolution process:

- ◆ consultation between the authority and the contractor in an attempt to come to a mutually satisfactory agreement (negotiation);
- ◆ expert determination by an expert appointed from a panel, with disputes relating to the mechanics of price variations going to a financial expert; and
- ◆ if either party is dissatisfied, referral to arbitration or litigation.

### Common pitfalls

There are a number of pitfalls associated with the use of multi-tiered dispute resolution clauses. Parties should be mindful of these when negotiating such clauses.

- ◆ It must be clear whether each step is optional or mandatory. If the clause is not sufficiently clearly drafted in this regard, there is a risk of procedural disputes, which will inevitably cost both time and money. If litigation is the final method of dispute resolution, parties will need to give serious thought to mediation, if it is optional. The English courts have powers to require parties to engage in an alternative dispute resolution process before using the court's resources or, in certain circumstances, impose costs sanctions on a party which has unreasonably refused to engage in an appropriate alternative dispute resolution process.
- ◆ If the steps are mandatory, there may be consequences if one party decides to skip them and go straight to court or arbitration. The stages of dispute resolution in cl 20 of the FIDIC Red, Yellow and Silver Books are

mandatory: in *Peterborough City Council [2014] EWHC 3193* court proceedings were stayed pending determination of the dispute by an adjudicator. In the context of arbitration, failure to comply with a mandatory step can be used as an effective means of challenging the jurisdiction of the tribunal on the basis that compliance is a prerequisite to arbitration. Therefore it can be important to comply with mandatory steps to avoid the risk of jurisdictional challenges, which are expensive and can cause delay.

- ◆ Parties must follow the agreed contractual mechanism for resolving disputes, as set out in the multi-tiered dispute resolution clause. The temptation to 'pick and choose' should be resisted. In *DGT Steel and Cladding Ltd [2007] EWHC 1584 (TCC)*, HHJ Coulson QC found, in an application for a stay of proceedings to allow an adjudication to take place, that there was a presumption in favour of the parties' agreement to adjudicate and this put the persuasive burden on the party resisting the stay to show good reasons why the proceedings should continue.
- ◆ A 'gap' has been identified in FIDIC's cl 20 (see above) where a dispute adjudication board has made a decision and one party gives notice of dissatisfaction with that decision and refuses to comply. What is the remedy? Refer the dispute to another DAB? Or, depending on the clause, commence litigation or arbitration? The answer may depend, to some extent, on the final stage of dispute resolution in the clause in question: (a) This issue was discussed obiter dicta by Edwards-Stuart J in *Peterborough City Council*. He could see no reason, where a clause provided for litigation as the final stage of dispute resolution, why the court could not intervene by ordering specific performance of the obligation to comply with the DAB's decision. Alternatively, if it was argued that the proper or only remedy was a further referral to a DAB, the court could assist the aggrieved party by refusing a stay of court proceedings. (b) Where arbitration is the final stage of dispute resolution, the position may be more complex. In the past, arbitral tribunals and courts have taken different approaches, meaning that there has been a lack of clear guidance on how to address the gap in cl 20. However, in *PT Perusahaan Gas Negara (Persero) TBK [2015] SGCA 30*, the

Singapore Court of Appeal decided that a DAB decision was enforceable as an interim award which disposed of a preliminary issue. To avoid the need for proceedings in future, FIDIC issued a Guidance Memorandum in 2013, which made it explicit that it is unnecessary for a party to refer a failure to comply with a DAB award back to a DAB and then to a process of amicable settlement before referring it to arbitration. FIDIC are expected to address the issue in the same way in the next editions of the Red, Yellow and Silver Books.

- ◆ A clause which includes an agreement to mediate must meet certain conditions for that agreement to be a condition precedent to arbitration or litigation. As set out in *Sulamerica [2012] EWHC 42 (Comm)* (a case which was upheld on appeal), there must be a sufficiently certain process, a defined administrative process for selecting a mediator, and the mediation process or a sufficient model of it should be included.
- ◆ Parties frequently second guess the type or nature of dispute which is likely to arise under a contract between them and draft the multi-tiered dispute resolution clause to favour a process suited to its resolution. However, when a dispute arises which they did not anticipate, they can find that their dispute resolution clause may let them down by not providing for an appropriate procedure to resolve it. Parties should pay careful attention to drafting this clause, even if they do not anticipate any disputes arising, and choose the form(s) of alternative dispute resolution based on what is suitable for the project and the disputes that are likely to arise from it.
- ◆ Parties often draft complicated clauses in an attempt to give themselves greater flexibility in the resolution of disputes. However, this can have the unintended consequence of delaying the resolution of disputes (for example by leading to procedural problems or arguments). The solutions are twofold. First, the parties should use clear drafting. The simpler, the better. Second, there should be clear triggers for distinct phases (such as negotiation or mediation) to begin and end, and specific time limits should be included.
- ◆ If the negotiation phase is prolonged, this may afford a party the opportunity to evade complying with its obligations. This can delay the project.
- ◆ If the parties are unsuccessful in resolving their dispute through the method(s) of alternative dispute resolution chosen, the costs which they have incurred (which may be sizeable and which may include the cost of external professionals in addition to the parties' own internal costs) might be said to have been wasted, unless some can be recovered in subsequent proceedings.
- ◆ Parties in a construction context do not always refer to or acknowledge mandatory statutory adjudication regimes in their dispute resolution clause. This can create an extra layer of dispute resolution which either takes one party by surprise or disrupts the timings and steps set out in the dispute resolution clause, causing uncertainty for the parties.
- ◆ For example, where works are carried out in the UK, s 108 of the *Housing Grants, Construction and Regeneration Act 1996* (and equivalent legislation in Northern Ireland) provides that a party to a construction contract (broadly speaking construction contracts are agreements that relate to the carrying out of construction operations, which are not otherwise exempted) has the mandatory right to refer a dispute to adjudication 'at any time'. Parties cannot contract out of this requirement. This means that parties cannot, by a multi-tiered dispute resolution clause, defer a party's right to start an adjudication at any time. If a construction contract does not provide the parties with a right to adjudicate at any time which meets certain minimum requirements, adjudication provisions set out in the Schemes for Construction Contracts applicable to England and Wales, Scotland, and Northern Ireland are implied into the contract.

### Conclusion

Multi-tiered dispute resolution clauses can work for the benefit of the parties, if drafted and used correctly. They can give parties recourse to a less formal, cheaper and quicker process for resolving disputes (though they cannot guarantee a successful early resolution).

However, as discussed above, there are a number of pitfalls for the unwary party. The key is to carefully consider the project and the disputes likely to arise before drafting a suitable clause which addresses the needs of the project, and is sufficiently clearly worded to avoid procedural arguments. **CL**