



LITIGATION

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DRAFTING DISPUTE RESOLUTION CLAUSES THAT WORK

Get them right before you have to manage a dispute



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Let's face it; the dispute resolution (DR) clause is not the most glamorous aspect of a commercial transaction. It's a bit like a prenuptial agreement – nobody wants to be the first to raise the topic and “we probably won't need it anyway”.

As a result, DR clauses often don't get the drafting attention they deserve. A poorly drafted DR clause can seriously undermine the efficient and cost-effective resolution of a dispute – months, and dollars, are often wasted on a dispute over how the dispute is to be resolved.

A timely reminder of such problems is the recent Court of Appeal decision in *Porter & Ors v Gullivers Travel Group Ltd* [2007] NZCA 345. This case involved proceedings up to Court of Appeal level to resolve a dispute between the parties as to how the substantive dispute between them was to be resolved. This was hardly the intention of the underlying DR clause, which was aimed at keeping the parties out of the court system.

This update considers a number of issues that commonly arise in relation to DR clauses and offers some drafting tips on how to avoid them.

First consideration: do you really want a DR clause?

Without a DR clause in your agreement,

then the default position is that either party may begin court proceedings in relation to a dispute.

A DR clause can contain any of the following processes as an alternative or precursor to litigation – mandatory negotiation, mandatory mediation, expert determination and arbitration.

- Negotiation will result in resolution if the parties agree on a settlement.
- Mediation involves a third party assisting the parties' negotiations and will only result in resolution if the parties agree on a settlement.
- Expert determination is used for fast track resolution of certain specific disputes – for example, valuation, accounting or similar technical disputes.
- Arbitration is the only true alternative to litigation, because it involves an adversarial process that results in a third party issuing a binding decision on the dispute.

Too often, commercial agreements include DR clauses involving long and tortuous steps that must be followed before a dispute can be litigated or arbitrated. For example, when the parties end up in a dispute, often they will have been

negotiating the issue for some time before one party triggers the DR clause's formal process. Once that occurs, the parties may then have to engage in weeks, if not months, of further mandatory negotiations before a formal claim can be issued.

Such forced negotiations are often used by one party as a delaying tactic.

Another example is requiring compulsory mediation very early in a dispute. Feedback from leading mediators is that too many disputes are going to mediation *undercooked* – usually as the result of a mandatory mediation clause.

While there is no doubt mediation is an effective means of resolving disputes, it is likely to be more help further down the track. At the outset of a dispute, a party often doesn't have a full understanding of its own position (both factual and legal), let alone the other party's position. Like mandatory negotiation, early mandatory mediation can be used by one party as a delaying tactic.

Accordingly, before putting a multi-tier DR clause into a contract, think carefully about whether it is really necessary and, if so, consider the following drafting tips.

Drafting tip 1 – keep any multi-tier DR clause short and simple

A key issue with multi-tier clauses is the length of time it can take to work through the various steps involved. Escalating negotiation clauses often involve second, third or even fourth layers which can take weeks, or longer, to comply with.

Sometimes, it can be helpful to have a round of formal, mandatory negotiations (for example, to remove the dispute from those with a personal interest in it), but, for example, do *all* disputes really have to be elevated to the CEO?

If mandatory negotiation is included, make

sure the various steps are kept to an absolute minimum and that fixed and short time limits are set before the parties can move onto the next stage (the parties can always agree at the time to extend time periods, if the process is going well). The process should be completed in days, not weeks.

Drafting tip 2 – remove all references to “reasonable endeavours”, “amicable negotiations” and “good faith negotiations”

Consider the following:

“In the event of a dispute, the parties shall use all reasonable efforts to amicably resolve the dispute through good faith negotiations. If the dispute is not so resolved then.....”

What does this mean? What does it require the parties actually do? By what standard is compliance to be measured? How long must the negotiations go on for? Is it enforceable in any event?

DR clauses often contain such provisions which often add nothing to the process and can cause serious problems. For example, there are many cases where one party has sought to delay the DR process by seeking to argue that the parties have not yet engaged in “amicable” negotiations.

The recent Court of Appeal decision in the *Gullivers* case is a prime example. The DR clause required the parties to “use their best endeavours to resolve the dispute by negotiation in good faith”, before the dispute could be referred for expert determination. That led to one party seeking court orders to restrain the other party from referring the dispute to the expert, on the basis that the parties hadn't yet engaged in “good faith” negotiations.

This resulted in High Court and then Court of Appeal proceedings, all of which would

most likely have been avoided had the clause been drafted without reference to such subjective and ultimately vague requirements.

Rather than including vague and uncertain language, give the parties something concrete to do. For example, specify that the parties must meet at least twice within a defined time period before the dispute can progress to the next stage. And if one party doesn't comply they cannot later set up that failure to prevent the other party from taking the dispute to the next level. A fundamental principle of contract law is that a party cannot benefit from their own wrong.

Drafting tip 3 - getting the mediation clause right

To be enforceable, a mediation clause must be sufficiently certain. It must address the mediation process and in particular, how the mediator is to be appointed – usually by mutual agreement. The clause should address what happens if the parties cannot agree. This will usually be by way of specifying that the mediator is to be appointed by a named institution, such as the Arbitrators' and Mediators' Institute of New Zealand Inc (AMINZ). It's also helpful to adopt a set of mediation rules and incorporate them by reference into the clause, for example, the AMINZ Mediation Protocol.

Drafting tip 4 - be aware of what disputes you are actually sending to expert determination and that the process is final

Expert determination is useful for fast tracking resolution of certain technical disputes. They are often resolved on the papers, sometimes with short submissions from the parties, in accordance with a procedure adopted at the discretion of the expert, and often within a very short time.

The expert is usually not legally trained, but will have relevant qualifications for the dispute – for example, an accountant, an engineer or a valuer. Expert determination is not suitable for full scale disputes involving complex legal and factual issues.

Despite this, parties often refer a much wider class of dispute than intended to expert determination, sometimes *all* disputes under the agreement. This is usually the result of poor drafting. There are a number of cases where the parties have spent months and thousands of dollars before the courts, arguing over whether a particular dispute can be brought before the court or, in accordance with the DR clause, must be referred to an expert for resolution.

For example, in a recent contract the author worked on, the contract contained a payment adjustment formula (contained in clause 23), with various inputs to the formula that were to be agreed by the parties. The parties intended that, if they couldn't agree on a particular input, the value of the input would be determined by an expert. The expert determination clause, as originally drafted, read:

“All disputes concerning payment shall be referred to an expert for determination in accordance with this clause.”

As will be appreciated, most disputes under a contract involve a dispute over payment!

A further attempt was made:

“Any dispute concerning clause 23 will be referred to an expert for determination in accordance with this clause.”

Again, this was too wide, as it could include a dispute as to either the triggering of clause 23, or the interpretation of clause 23.

A more suitable clause, capturing only the disputes the parties intended to send to the

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expert, was:

“Any dispute concerning the value of the inputs to the payment formula contained in clause 23 will be determined by an expert in accordance with this clause.”

Once the scope of the disputes to be referred to an expert is settled, the clause should also set out some of the basic provisions concerning process, including a process for appointing the expert.

The clause will also normally specify the expert’s qualifications, or experience.

As to finality, expert determination is risky, as a determination can be very difficult to overturn. There are limited grounds and even a serious error by the expert will not by itself be sufficient. The courts have refused to imply a term into an expert determination clause that the determination must be reasonable and free from error. The error must be of such a nature as to render the determination not a “determination” under the contract at all (in this way, a “jurisdictional” error).

Drafting tip 5 – if choosing arbitration, keep the clause short and simple and be sure to address the arbitration “basics”

Where arbitration is specified, the DR clause should address:

- the fact that the dispute is to be referred to arbitration;
- the number of arbitrators – usually one or three (do not, for obvious reasons, choose an even number of arbitrators);
- an appointment process for the arbitrator, including if the parties fail to agree on the arbitrator (the default position under the Arbitration Act 1996 is that the High Court can appoint the arbitrator, but it will be quicker and cheaper to have an institution, such as AMINZ, act as the default appointing

authority);

- incorporate by reference any chosen arbitration rules;
- specify the place of arbitration – useful for a domestic transaction and crucial in a cross-border transaction; and
- in the context of a cross-border transaction, specify the language of the arbitration (you don’t want to be the party who pays for translating all their documents).

An arbitration clause along the following lines is all that should be required:

“Any dispute, difference or claim arising out of or in connection with this agreement, or the subject matter of this agreement, will be referred to and finally resolved by arbitration in accordance with the [specify particular arbitration rules] (“Rules”). The tribunal will consist of [a sole arbitrator/three arbitrators] appointed in accordance with the Rules. The place of arbitration will be [specify place.] The language of the arbitration will be [English].”

If arbitration takes place in New Zealand (and, therefore, the New Zealand Arbitration Act is to apply), the parties should also consider contracting out of or into various optional provisions contained in the Act, for example, appeals on points of law.

Finally, dispute resolution in cross-border transactions is a complex area. Specialist advice should be sought on DR clauses for such transactions.