

APPENDIX H

MULTI-TIERED DISPUTE RESOLUTION CLAUSES

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1. Introduction

Multi-tiered dispute settlement mechanisms are designed to facilitate a rapid and cost effective settlement of disputes. Dispute resolution clauses often provide a complex, multi-step ADR mechanism with binding arbitration as the procedure of last resort. Contractual clauses providing for conciliation or mediation as a pre-condition to arbitration, or clauses providing for the resolution of the dispute by a board of engineers, allow a cost-efficient and flexible method to settle construction disputes, avoiding lengthy proceedings and limiting the issues that may eventually have to be decided by an arbitral tribunal.

A mediator or conciliator will not issue a binding decision, but may assist the parties to reach agreement or to better understand each other's position. Only if the dispute has not been resolved by mediation within a given period of time, the parties may resort to arbitration. Another possibility is the use of panel or board of engineers, often called Dispute Resolution Boards or Dispute Adjudication Boards,¹ allowing technical issues to be handled by experts on the matter before the arbitral tribunal considers them.

The traditional role of the Engineer in international construction disputes, of evaluating and assessing technical issues, has evolved in today's Dispute Resolution Boards. Although the work of valuation and technical assessment continues, Dispute Resolution Boards are increasingly seen today as "decision makers" or adjudicators.

The use of Dispute Resolution Boards can be seen in today's major construction projects. In the Channel Tunnel project, disputes had to be submitted to a panel of experts and then, if any of the parties so requested, to international arbitration under the ICC Rules. Also, in the Hong Kong Airport project, the contract provided a four-tiered dispute resolution clause, including first, the submission of disputes to an Engineer followed by mediation, adjudication and arbitration.

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¹ Terminology in this area is not consistent. Under the FIDIC conditions, dispute resolution boards are called Dispute Adjudication Board, while under the World Bank's standard bidding documents these boards are called Dispute Resolution Boards, even though both figures are similar in nature.

This article outlines the main features of third-party assisted settlement as a condition precedent to arbitration. In this context, it considers questions relating to enforcement of multi-step dispute resolution clauses in international contracts and other jurisdictional issues. As the steps prior to arbitration do not constitute arbitration agreements *strictu sensu*, fundamental issues arise in the context of enforcement of the ADR portion of the clause, both in relation to the certainty of the clause and in connection with the time limited for the mandatory ADR mechanism.

2. Dispute resolution boards

Engineering and construction contracts often involve disputes of a highly technical nature that require the intervention of independent experts. In practice, these contracts prevent the parties from resorting to international arbitration by requiring them to submit disputes to a board or panel of impartial professionals, formed at the beginning of the project to follow construction progress and to solve disputes while the project is ongoing (hereinafter, generally referred to as “dispute resolution board” or “DRB”).

Dispute Resolution Boards are panels of experienced and impartial experts, established when the execution of the contract begins. Usually, DRB are composed of one or three members agreed by the parties. Two of the members of the panel are selected by each of the parties, with consent of the other; and the third one is typically selected by the two nominees.

It is generally an express requirement that the DRB contacts the parties, gets familiar with the details of the project and makes regular visits to the site at times of critical construction events.²

Expert intervention in the resolution of construction disputes was first launched by the World Bank in 1980, in the context of the Bank’s project of El Cajon Dam, in Honduras. As a major funder, the World Bank saw the necessity and required the intervention of an expert to solve potential disputes that could arise between the Honduran owner, the Italian contractor and the Swiss engineer. Since then, the financing documents of the World Bank have required the intervention of an expert decision maker in large engineering and infrastructure projects. Today, World Bank funding of works, supply, installation and turnkey contracts, requires that these contracts endorse “...mechanisms such as dispute review boards or adjudicators ... designed to permit a speedier dispute settlement.”³

The intervention of a sole Engineer paid by the employer, raised impartiality concerns, which facilitated the acceptance of DRB in international construction disputes. The World Bank introduced the DEB system into its Standard Bidding Documents for Procurement of Works in 1995, requiring borrowers who were performing World Bank’s

² See the FIDIC Orange Book – Appendix A, clause 1 of the Model Terms of Appointment for a Dispute Adjudication Board.

³ Section 2.42 of the World Bank Guidelines of Procurement under IBRD Loans and IDA Credits (1999), available at <http://info.worldbank.org/etools/docs/library/38449/procguid-ev3.pdf> (last visited September 10, 2004).

projects to replace the intervention of a sole Engineer empowered to render recommendations, binding on the parties unless either party challenged the recommendation.

The construction documents of the Federation Internationale des Ingenieurs-Conseils (“FIDIC”) endorsed a similar system in 1996, with the publication of a supplement to the 1987 Red Book, introducing the Dispute Adjudication Board as an alternative to the Engineer and empowered to issue binding decisions.

Subsequently, in 1999, FIDIC published the first edition of four new standard forms of construction contracts: (a) Conditions of Contract for Construction; (b) Conditions for Plant and Design Build; (c) Conditions of Contract for EPC/Turnkey Projects; and (d) Short Form Contract. Clause 20 of these Conditions establish a two-tier procedure for the resolution of disputes, requiring the parties to submit any claim that may arise between them to consideration by a DRB, as a pre-condition to arbitration. The decision of the DRB binds the parties unless they challenge it within a given period of time. Failure to submit a dispute for prior decision of the DRB acts as a bar to arbitration.

More recently, the World Bank has enhanced, in the standard bidding documents, the authority of the DRB, making binding the findings of the DRB, in the same way as FIDIC’s Dispute Adjudication Boards. The World Bank’s 2000 Edition of the Standard Bidding Documents for Procurement of Works states that the recommendation of the DRB is binding on both parties, unless revised in subsequent arbitration proceedings, but retains the 14-day deadline for notice of intention to commence arbitration, after the expiry of which the recommendation becomes final and binding.

In addition, the Institute of Civil Engineers and the Dispute Resolution Board Foundation, established in 1996, have been very active promoting the use of Dispute Resolution Boards and providing information and education to parties involved in construction disputes.

Recently, the International Chamber of Commerce (ICC) and its Centre for Expertise, enhanced its activities in this field and in 2001 set forth a Task Force on Dispute Boards in charge of drafting a set of Rules for Disputes Boards. In 2003, this Task Force issued a set of Draft Rules for Dispute Boards, allowing for a choice of (a) non binding recommendations of a DRB; (b) adjudication decisions by a Dispute Adjudication Board; and (c) a combined approach, where a Combined Dispute Board may decide whether a Recommendation or a Decision is appropriate under the circumstances.

As from September 2004, ICC offers a set of Rules for DRB and the manner in which they operate, to be used by the international business community.

ICC Dispute Review Boards (ICC-DRBs) issue “recommendations” which may be complied with voluntarily but do not impose on the parties any binding obligation until a final resolution of the dispute by arbitration or litigation. However, if none of the parties challenges the recommendation, it is assumed that the parties have waived any right of recourse against the ICC DRB’s recommendation.

ICC Dispute Adjudication Boards (ICC-DAB) issue binding “decisions” that the parties have to comply with. However, if a party expresses dissatisfaction with the decision, it may refer the dispute to arbitration or litigation before the courts. Until the dispute is decided by the courts or the arbitrators, the parties remain contractually bound by the decision of the ICC-DAB. Further, if no party challenges the decision, it is understood that the parties have contractually agreed and accepted the content of the decision, waiving any right of recourse against it.

Finally, the ICC Dispute Board Documents give the parties the possibility to choose a so-called Combined Dispute Board (CDB). The CDB issues the same recommendation as the DRB but it may issue a binding decision if a party so requests and the other does not object. Otherwise, it is for the CDB to determine whether to issue a recommendation or a decision on the particular dispute, in accordance with the criteria set forth in the ICC Dispute Board Rules.

Under the ICC Rules for DRB, the ICC does not administer these type of escalating proceedings but plays the subsidiary role of appointing members of the Board and reviewing recommendations, if a party so requests. The ICC Dispute Board Centre is responsible for performing these functions, which is an organ independent of the ICC International Court of Arbitration, the the ICC International Centre for Expertise and the ICC ADR Secretariat.⁴

3. The role of dispute resolution boards

Boards not only offer third-party assisted settlement in construction disputes but intervene to avoid potential disputes by making periodic site visits and meeting with the parties. Boards are neither courts of law nor arbitral tribunals. They are informal bodies that provide independent expert assistance enabling resolution of disputes without the need to resort to arbitration. Indeed, Boards play a major role in assisting the parties in the avoidance of potential conflicts and in the settlement of current disputes.

Board recommendations have a strong persuasive but non-obligatory character, as these bodies usually render mere recommendations devoid of binding effects if within a given period of time following its receipt, either party gives notice to the other party of its intention to submit the dispute to arbitration.

FIDIC’s DRBs render binding decisions as a quasi-tribunal or dispute adjudicator, intended to take immediate effect. Under the previous FIDIC Conditions, disputes had to be submitted to the engineer before going to arbitration. The engineer was expected to decide as a neutral or impartial adjudicator. DRBs under the 1999 FIDIC Conditions have taken over the role of the Engineer under the former Conditions, with the power of making binding decisions, even if notice is given of intention to refer the dispute to arbitration.

⁴ Further information on the ICC DRB procedure see http://www.iccwbo.org/drs/english/dispute_boards/all_topics.asp (last visited, September 15, 2004).

In general, Boards help the parties to settle disputes in a cost-effective manner avoiding further conflicts between them. The presence of these Boards is often enough to ensure an amicable settlement. Moreover, Boards ensure that the parties remain focused on the project rather than in a time consuming dispute. Overall, these Boards ensure a confidential and informal forum in which to settle differences and ultimately a smooth development of the project.

4. Board Procedures

As Boards are established by contract, the dispute settlement procedure will be dictated by the provisions of the contract, which will generally be flexible, informal and appropriate to the nature of the dispute.

The procedure starts when the parties are not able to resolve a given dispute, which is formally referred to the DRB for a hearing and a written recommendation.

Hearings are generally informal, with no cross examination. Attorneys are not involved and do not have a representative capacity as in litigation or arbitration proceedings; and the parties decide the amount and extension of the information they wish present before the Board.⁵

Boards generally have the power to review all disputes between the parties and to issue recommendations. The World Bank standard bidding conditions and the FIDIC Contracts state that if the parties to a dispute do not object to a recommendation or a decision, it becomes binding. However, if they are dissatisfied, they may proceed to arbitration or litigation.

Under the 1999 International FIDIC Conditions, DRBs would only come into play when there is a “dispute” between the parties. The Arbitral Award in the ICC Case No. 6535 dealt with the meaning of “dispute” under the FIDIC Conditions. In that case, the contractor had sent letters to the engineer claiming relief for extension of time and payment for variations in the scope of works. The issue was whether these letters amounted to referrals of disputes to the engineer. The Tribunal held:

before a claim or contention can constitute a dispute ... it must first have been submitted and rejected under the contract. It follows that if the matters submitted to the Engineer are claims which have not previously been rejected, they cannot be regarded as submitted under Clause 67 whatever language is used in the submission.

As the Engineer had not yet dismissed the claims, the Arbitral Tribunal considered that there was no “dispute” between the parties and therefore, the tribunal had no jurisdiction.

⁵ Kathleen M. J. Harmon, “Construction Conflicts and Dispute Review Boards: Attitudes and Opinions of Construction Industry Members,” 58-JAN Disp. Resol. J. 66 at 74 (November 2003 – January 2004).

The DRB procedure will only be applicable if there is a “dispute” between the contractor and the employer – i.e., a claim that has been rejected by the engineer over a matter that the contractor seeks relief.

In case No. 6238, the issue was the meaning and scope of a valid submission to the Engineer under the FIDIC Conditions. The Arbitral Tribunal held that any submission to the engineer under the FIDIC Conditions must clearly refer a dispute to him; and it is not enough for a party to state a mere intention to submit a dispute to the engineer.

Under the Clause 20.4 of the current FIDIC Conditions,

If a dispute (of any kind whatever) arises between the Parties in connection with, or arising out of, the Contract or the execution of the Works, including any dispute as to any certificate, determination, instruction, opinion or valuation of the Engineer, either Party may refer the dispute in writing to the [DRB] for his recommendation, with copies to the other Party and the Engineer. Such reference shall state that it is given under this Sub-Clause.

Clause 20.4 of the FIDIC Conditions requires the DRB, acting as a panel of experts, to give its recommendation within 84 days, “...after receiving such reference, or within such other period as may be proposed by the [DRB] and approved by both Parties....” The reference in writing to the DRB shall contain

all information, access to the Site, and appropriate facilities, as the Conciliator/[DRB] may require for the purposes of making a decision on such dispute.

If a party is dissatisfied with the DRB’s decision – or the Board fails to reach a decision within the abovementioned 84 days – either party may notify the other party of its dissatisfaction, within 28 days; otherwise, the Board’s decision becomes final and binding.

Thereafter, both parties have a period of 56 days to reach an amicable settlement of the dispute. Finally, if the dispute has neither become final and binding, nor been amicably settled, it may be submitted to international arbitration.

4. Jurisdiction of arbitral tribunals and non-compliance with multi-tiered dispute settlement provisions

Non-compliance with the pre-arbitration dispute settlement mechanism envisaged under multi-tier dispute resolution clauses –requiring the dispute to be decided by an Engineer or a Board as a condition precedent to arbitration– may result in the lack of jurisdiction of the arbitral tribunal. An example in point is the pre-arbitration dispute settlement mechanism addressed in the FIDIC General Standard Conditions in their different modalities (Civil, Mechanical, Electrical, Turn-Key, etc.). Compliance or non-compliance with this requirement may determine the arbitral tribunal’s jurisdiction.

When confronted with jurisdictional objections related to failure to comply with a multi-tiered dispute resolution clause, arbitral tribunals will resort to the well-known doctrine of *Kompetenz-Kompetenz*. Under Article 16 of the UNCITRAL Model Law, the arbitral tribunal may "... rule on its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement." The Model Law is nevertheless silent as to the enforceability of mediation, conciliation or like processes that the parties have addressed in the contract as a precondition to arbitration.

Pursuant to Article 6.2 of the ICC Rules, if one of the parties raises a jurisdictional objection that the requirement under the contract's dispute resolution clause has been disregarded, the ICC International Court of Arbitration may decide anyway

...that the arbitration shall proceed if it is prima facie satisfied that an arbitration agreement under the Rules may exist. In such a case, any decision as to the jurisdiction of the Arbitral Tribunal shall be taken by the Arbitral Tribunal itself.

Accordingly, the Arbitral Tribunal is not bound by the Court's decision that an arbitration agreement exists, and may render a final decision as to its jurisdiction in an interim or final award.⁶

Unless there is a clear requirement for the parties to comply with a multi-tier dispute resolution clause, as required for example under the FIDIC Conditions, Arbitral Tribunals will tend to hold that they have jurisdiction when the wording of the dispute resolution clause makes the use of ADR optional.⁷

In the ICC Case No. 4230,⁸ the parties had entered into a contract which contained an arbitration clause, with the caveat that the parties should first enter into conciliation proceedings before submitting the dispute to arbitration. The claimant initiated arbitration proceedings without undertaking conciliation proceedings with the defendant. Following the defendant's jurisdictional objection, the Tribunal held that it had jurisdiction to hear the dispute because it interpreted the clause as not being compulsory.

However, when the arbitration agreement sets forth a clear obligation of the parties to take prior dispute settlement steps before entering into arbitration, arbitral tribunals will decline jurisdiction. Such clear obligation has for instance been endorsed in Clause 67 of the former FIDIC Conditions and Clause 20 of the current Conditions. Under the FIDIC Conditions, the parties are clearly required to submit the matter to a DRB before they can refer the dispute to arbitration. Also, under the previous 1989 FIDIC Conditions, the parties had to take two mandatory steps before initiating arbitration proceedings: first, to submit the dispute to the Engineer for its recommendation; and second, if such recommendation was not acceptable, to attempt to settle the dispute amicably.⁹

⁶ W.L. CRAIG, W.W. PARK, J. PAULSSON, *International Chamber of Commerce Arbitration* (2000) at 155.

⁷ Dyalá Jiménez Figueres, "Multi-Tiered Dispute Resolution Clauses in ICC Arbitration," ICC International Court of Arbitration Bulletin Vol. 14/NO.1 – Spring 2003.

⁸ ICC Case No. 4230, JDI, 1975, pp. 934 – 938.

⁹ See Fédération Internationale des Ingénieurs-Conseils (FIDIC), *Guide to the Use of FIDIC Conditions of Contract For Works of Civil Engineering Construction (Fourth Edition)*, at 153 (1989).

In the ICC Cases No. 6276 and 6277 the arbitral tribunals did not find jurisdiction in a situation involving clause 67 of the 1989 FIDIC Conditions on grounds that the claimant failed to satisfy the condition precedent set forth in the dispute resolution clause. In these cases, the functions of the Engineer had been carried out by various individuals and organizations because the employer never appointed an Engineer. The contractor initiated arbitration proceedings without previously submitting the dispute to an

Engineer, as prescribed in the contract's dispute resolution clause, because the employer never notified the contractor the name of the engineer that responsible for that pre-arbitral function.¹⁰

The Arbitral Tribunal held that the claimant had not complied with the pre-arbitral phase established in the dispute resolution clause and the submission to arbitration was premature. The Tribunal reasoned that the claimant should have requested the employer to designate an Engineer to whom submit the dispute instead of initiating arbitration proceedings.¹¹ In particular, the Tribunal held that

...the claimant ... was under a duty to put the defendant on notice to indicate to it the name of the engineer to whom the dispute could be submitted. It was only if it had met with a refusal or in the event of the failure to reply on the part of the defendant that the claimant could have been dispensed from complying with this pre-arbitral phase.¹²

Consequently, the Arbitral Tribunal dismissed the request for arbitration and ordered the claimant to formally demand from the defendant the designation of an Engineer to hear the dispute before the matter could be referred to arbitration.

In the ICC Case No. 6535 the Arbitral Tribunal dealt with the issue of what constitutes a valid submission to the engineer in order to determine whether the claimant complied with the mandatory pre-arbitral phase. The Tribunal considered that the claimant (the contractor) did not comply with the first tier of the dispute resolution clause, requiring the parties to submit any dispute to the Engineer, when the contractor had already sent letters to the Engineer claiming relief in relation to extension of time and variation of works.¹³ The Arbitral Tribunal considered that these letters did not amount to a valid referral of disputes to the Engineer because the contractor's claims had not been rejected by the Engineer and, therefore, "...cannot be regarded as submitted under Clause 67 whatever language is used in the submission."¹⁴

¹⁰ Christopher R. Seppala, "International Construction Contract Disputes: Commentary on ICC Awards Dealing with FIDIC International Conditions of Contract," ICC International Court of Arbitration Bulletin Vol. 9/NO.2 – November 1998.

¹¹ Id.

¹² ICC Cases No. 6276 and 6277, ICC International Court of Arbitration Bulletin Vol. 14/NO.1 – Spring 2003, p. 78.

¹³ See comment by Dominique Hascher discussing the award rendered in ICC Case No. 6535, involving a construction contract. Yves Derains et al., *Cour Internationale D'Arbitrage de la Chambre de Commerce Internationale*, 120 *Journal du Droit International (J.D.I.)* 1001, 1024 (1993).

¹⁴ Christopher R. Seppala - Member of the New York and Paris Bars; partner, White & Case, resident in Paris; and Legal Advisor to the FIDIC Task Group for updating the FIDIC International Conditions of Contract (1994 to the present), published in the *International Court of Arbitration Bulletin*, vol. 9/No.2 – November 1998.

The ICC Case No. 9984 concerned two construction contracts requiring the parties to attempt to settle disputes amicably, through conciliation, before resorting to arbitration proceedings. Under the contracts, only if that attempt had failed, if one of the parties had informed the other to this effect in writing, the parties could submit the dispute to arbitration.

Among the jurisdictional issues before the arbitral tribunal was whether the claimant had satisfied the first tier of the dispute resolution clause when, before filing the request for arbitration, it wrote to the respondents inviting them to discuss the dispute in an amicable way; and informing them about the claimant's intention to initiate arbitration proceedings if no solution was reached within a given period of time. The Arbitral Tribunal found that by the date addressed in the claimant's letter, without the parties being able to reach an amicable solution of the dispute, the claimant exhausted the first tier of the dispute resolution clause and was thereby entitled to initiate arbitration proceedings.

The ICC Case No. 10256¹⁵ arose out of a power purchase agreement between the parties, providing for the settlement of disputes by mutual discussions of the parties and through expert mediation. In particular, the dispute resolution clause of the agreement provided as follows:

...In the event that the parties are unable to resolve a dispute [by mutual discussions], then either Party ... may refer the dispute to an expert for consideration of the dispute.... Any Dispute arising out of or in connection with this Agreement and not resolved following the procedures described [above] shall ... be settled by arbitration....

The Respondent contended that the dispute resolution clause should be read to mean that mediation of an expert was a condition precedent for arbitration and that the claimant was not entitled to initiate arbitration proceedings until there was expert mediation. The Arbitral Tribunal affirmed its jurisdiction on the grounds that the word "may" in the dispute resolution clause indicated that reference to expert mediation was not mandatory but merely optional; and therefore, "...either party is free to refer the dispute to arbitration ... whether or not there have been good faith mutual discussions ... or a reference to mediation by an expert...."

The abovementioned cases illustrate the jurisdictional difficulties that may arise in the context of a multi-tiered clause. In general, the reaction of arbitral tribunals towards objections to jurisdiction as a result of the claimant's non-compliance with the pre-arbitral phase has been that "...where the wording of the dispute resolution clause makes the use of ADR optional, a party is entitled to submit a request for arbitration whenever it wishes...."¹⁶

The issue of whether a multi-tiered dispute resolution clause raises a valid condition precedent to arbitration is a question of jurisdiction. As abovementioned, under the *Kompetenz-Kompetenz* principle, it is question to be ascertained by the arbitral tribunal itself; but the effectiveness or ineffectiveness of the clause will nevertheless depend on

¹⁵ ICC Case No. 10256, ICC International Court of Arbitration Bulletin Vol. 14/NO.1 – Spring 2003, p. 87.

¹⁶ Jiménez Figueres, *supra* note 7 at 72.

whether or there is doubt about the parties' intention to resolve the dispute by arbitration if ADR fails.

In addition, there are always certain exceptions that allow the parties to resort directly to arbitration without following all the tiers addressed in escalating dispute resolution clause. This would be the case "...where interim relief of some sort is required."¹⁷ Accordingly, it is advisable that the parties provide in the dispute resolution clause that they "...retain the right to seek interim relief from an appropriate court or arbitration tribunal."

5. Enforceability of multi-tiered dispute resolution clauses

When one of the parties fails to comply with the dispute settlement mechanism addressed in a multi-tiered clause, national courts may intervene to enforce the dispute settlement agreement.

National courts have adopted different approaches regarding enforceability of multi-tiered dispute resolution clauses.¹⁸ Some jurisdictions consider that only the second tier (the arbitration agreement) but not the first tier (the agreement to negotiate) can be enforced, while others consider the entire dispute resolution clause enforceable.¹⁹ In general, enforceability of the first tier will depend on whether the dispute resolution clause provides a clear obligation of the parties to follow the pre-arbitral ADR procedure.

The issues that arise in the context of enforceability are whether an agreement to negotiate or mediate is enforceable; and whether the existence of multiple ADR procedures combined with arbitration impair the application of enforcement conventions,²⁰ such as the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (hereinafter, the NY Convention). The NY Convention does not specifically state whether a DRB clause or an arbitration clauses precede by an ADR clause is a bar to litigation before the domestic courts.

The traditional common law position has been that the uncertainty of agreements to negotiate makes them unenforceable as they do not create binding obligations.²¹ The Court of Canada and the United Kingdom have maintained this position while the emerging position in the U.S. seems to be that "...agreements to negotiate are enforceable if the terms are sufficiently definite."²² The modern U.S. position is that "...agreements to negotiate in good faith, unlike mere 'agreements to agree,' are not

¹⁷ JULIAN D. M. LEW, LOUKAS A MISTELIS, STEFAN M. KRÖLL, *Comparative International Commercial Arbitration* (2003), p. 184.

¹⁸ Robert H. Smith and Audley Sheppard, "Enforcement of Multi-Tiered Dispute Resolution Clause - Introduction," *Arbitration and ADR Newsletter of the IBA*, Vol. 6, No. 2 - October 2001

¹⁹ *Id.*

²⁰ See Michael Pryles, "Multi-Tiered Dispute Resolution Clauses," 18 *Journal of International Arbitration*, vol. 18, issue 2, April 2001, pp. 159-176.

²¹ Pierre Bienvenu, "The Enforcement of Multi-Tiered Dispute Resolution Clauses in Canada and the United States," Annual Convention, International Bar Association (2002).

²² *Id.*

enforceable as a matter of law....”²³ However, the non-binding provisions contained in multi-tiered dispute resolution clauses are increasingly enforced upon the application of the Federal Arbitration Act (“FAA”) and the use of contract law principles.²⁴

Several U.S. Courts have relied on the FAA and applied it to mediation on the grounds that the latter falls within the scope of arbitration, since the concept of arbitration embraces all contractual dispute resolution mechanisms, in accordance with the U.S. Congress’ intention to enhance alternative methods of dispute resolution.²⁵ In particular, some States have enacted legislation concerning enforcement of mediation clauses as a pre-condition to litigation; but these statutes are only applicable to arbitration by analogy.²⁶

In addition, U.S. contract law principles have been used to enforce multi-tiered dispute resolution clauses under the general rule that “...when a party contracts to use mediation prior to the commencement of arbitration (or litigation), the contractual agreement cannot be bypassed without a valid defense, eg. waiver or estoppel....”²⁷

British Courts have also recognized the principle that courts or arbitrators should stay proceedings on a claim brought in breach of a multi-tiered dispute resolution clause, requiring the parties to enter into a give ADR procedure before initiating arbitration or regular court proceedings, when there is a clear intention of the parties to be bound by a previous mandatory ADR procedure. This principle is particularly true when there is sufficient certainty of engagement – i.e., when the parties have gone in the contract beyond a mere intention to negotiate in good faith.

In the Channel Tunnel case,²⁸ the dispute arose out of a construction contract including a multi-tiered dispute resolution clause. The first tier required the parties, as a condition precedent, to submit the dispute to a panel of experts. If either party wished to have the experts’ decision reviewed, that party could then submit the dispute to arbitration. The issue before the Court was whether the dispute that arose under the construction contract could be brought to arbitration when the first tier of the dispute resolution clause had not been respected. The appellant without complying with the contract’s process of dispute resolution filed a writ of summons at the High Court requesting an injunction from the Court to restrain the respondent from suspending construction works. The respondent applied for a stay of proceedings based on the existence of contractual mandatory preliminary stages for dispute resolution. The House of Lords held:

[T]hose who make agreements for the resolution of disputes must show good reasons for departing from them. But also with the interest of orderly regulation of commerce that having promised to take their

²³ Howtek, Inc. v. Relisys, et al., 958 F. Supp. 46, 48 (1997) *citing* Channel Home Ctrs. v. Grossman, 79 F.2d 291, 299 (3rd Cir.1986).

²⁴ Kathleen Scanlon, “Enforcement of Multi-Tiered Dispute Resolution Clause - United States,” *Arbitration and ADR Newsletter of the IBA*, Vol. 6, No. 2 - October 2001, p. 24.

²⁵ *Id.* *citing* Cecala v. Moore, 982 F.Supp. 609 (ND III 1997).

²⁶ *Id.*

²⁷ *Id.*

²⁸ Channel Tunnel Group Ltd (UK) and France Manche S.A. (Fr.) v. Balfour Beatty Construction Ltd. (UK) et. al., [1992] Q.B. 656 (C.A.)

complaints to the experts and if necessary to the arbitrators, that is where the appellants should go.

The Holding of the House of Lords in Channel Tunnel was subsequently incorporated in Section 9 (2) of the English Arbitration Act of 1996²⁹ which provides as follows:

An application [to stay court proceedings] may be made notwithstanding that the matter is to be referred to arbitration only after the exhaustion of other dispute resolution procedures.

In Cable & Wireless Plc. v. IBM United Kingdom Ltd.,³⁰ before the British Commercial Court, the dispute referred to an agreement by IBM to supply information technology services to Cable & Wireless. The contract between the parties included a multi-tiered clause drafted in the following terms:

If the matter is not resolved through negotiation, the Parties shall attempt in good faith to resolve the dispute or claim through an Alternative Dispute Resolution (ADR) procedure as recommended to the Parties by the Centre for Dispute Resolution. However, an ADR procedure which is being followed shall not prevent any Party or Local Party from issuing proceedings.

When Cable & Wireless commenced proceedings, IBM sought to enforce the dispute resolution clause to trigger the ADR process addressed in that clause. The main issue before the Court was whether the multi-tiered dispute resolution clause required the parties to engage in an ADR procedure as a condition precedent to litigation.

In Cable & Wireless, the Court considered that the escalating clause contained an enforceable obligation to participate in ADR procedures, "...a sufficiently defined mutual obligation upon the parties both to go through the process of initiating a mediation, selecting a mediator and at least presenting that mediator with its case...." The Court further reasoned:

[T]he reference to ADR is analogous to an agreement to arbitrate. As such it represents a free-standing agreement ancillary to the main contract and capable of being enforced by a stay of the proceedings or by injunction absent any pending proceedings.

The solution adopted in Cable & Wireless v. IBM was subsequently shared by a French Court in Poiré v. Tripiér (2003). Both cases referred to the question of non compliance with a contractual clause ordering ADR prior to initiation of legal proceedings.

²⁹ Christopher R. Seppala, "The Arbitration Clause in the New (1999) FIDIC Contracts" (2003), available at <http://www1.fidic.org/resources/contracts/seppala.asp> (last visited September 10, 2004).

³⁰ [2002] All E.R. (D) 277, reprinted in *Arbitration International*, vol. 19, No. 3 (2003) pp. 352 – 362. For a commentary on the decision see Karl Mackie, "The Future for ADR Clauses After Cable & Wireless v. IBM," *International*, vol. 19, No. 3 (2003) pp. 345 – 351.
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In civil law countries “...the trend is for courts to enforce clauses that provide for an ADR procedure to be observed before arbitration or litigation...”³¹ In Tripier, the dispute related to a contract in which the dispute resolution clause required the parties to resort to mediators prior to commencing legal proceedings. In particular, the contract provided that any dispute between the parties should be submitted to mediators designated by the parties; and that the mediators would endeavor to resolve the dispute within a period of two months from their designation. When a dispute arose between the parties Mr. Poiré commenced legal proceedings without respecting the dispute resolution clause in the contract. The Court of First Instance rendered a decision on the merits without entering into the issue of the breach of the mediation clause.

The Court of Appeal of Paris upheld the appeal and dismissed Mr. Poiré’s claim.³² The French Cour de Cassation upheld the lower court reasoning that “...a contractual clause establishing a mandatory mediation procedure prior to legal proceedings ... constitutes an obligatory bar to proceedings if invoked by the parties...”³³

The decision of the French Court in Poiré v. Tripier is consistent with Article 13 of the UNCITRAL Model Law which provides as follows:

Where the parties have agreed to conciliate and have expressly undertaken not to initiate during a specific period of time or until a specified event has occurred arbitral or judicial proceedings with respect to an existing or future dispute, such an undertaking shall be given effect by the arbitral tribunal or the court until the terms of the undertaking have been complied with, except to the extent necessary for a party, in its opinion, to preserve the rights. Initiation of such proceedings is not of itself as a waiver of the agreement to conciliate or as a termination of the conciliation proceedings.

Also, in accordance with French contract law, under Article 1134 of the French Civil Code,

Agreements lawfully entered into take the place of the law for those who have made them. They may be revoked only by mutual consent, or for causes authorized by law. They must be performed in good faith.

Therefore, under French law, ADR agreements create legally binding obligations: first, to enter into negotiations with the other disputing party; and second, to act in good faith with the aim to settle the dispute. In Peyrin v. Société Polyclinique des Fleurs,³⁴ the French Court of Cassation held that non-compliance with a conciliation agreement in a multi-tiered clause prevented receiving an action on the merits until the parties attempted to resolve the dispute through conciliation.³⁵

³¹ Seppala, supra note 10.

³² For a commentary on the case see Charles Jarrosson, “Observations on Poiré v. Tripier,” 19 *Arbitration International*, No. 3 at 36.

³³ Id. at 368.

³⁴ Peyrin et autres c/ Société Polyclinique des Fleurs, Court of Cassation, Commercial Chamber, July 6, 2000.

³⁵ Jason Fry, “Enforcement of Multi-Tiered Dispute Resolution Clause - France,” *Arbitration and ADR Newsletter of the IBA*, Vol. 6, No. 2 - October 2001, p. 14.

Other civil law countries recognize the enforceability of multi-tiered dispute resolution clauses before courts. In Spain, multi-tiered dispute resolution clauses are enforceable if a definitive obligation is made a precondition to arbitration. A clause providing that arbitration cannot be initiated until a fixed period of time has elapsed will not be enforceable until that period has expired.³⁶ Similarly, an obligation to appoint a representative for the purpose of negotiating, or an obligation to refer the matter to a designated mediator as a precondition to arbitration, will have the consequence that the obligation to arbitrate does not arise until the pre-arbitral phase has been exhausted.

However, a broad obligation simply to negotiate in good faith or to mediate prior to commencing arbitration proceedings will most likely be unenforceable, notwithstanding the express contract law duty of good faith.³⁷

7. Conclusion

Multi-tiered dispute resolution clauses allow the parties to identify potential conflicts and to settle them before their position becomes too divergent to be settled outside the scope of arbitration or litigation. Early recognition of conflicts and their reference to a Board or panel of experts allow the parties to settle conflicts while the contract or project is ongoing.

Dispute Resolution Boards represent a cost-effective method of resolving conflicts between the parties, but escalating dispute resolution clauses should be carefully drafted to avoid potential problems of enforceability. In particular, it is important that a multi-tiered clause perfectly clearly states the parties' intention to resolve future disputes by arbitration if the previous ADR procedure addressed in the clause fails. It is impossible to compel the parties to negotiate in good faith or to reach a settlement if a dispute arises, but careful design of a dispute resolution clause can guide the parties into a structured process, involving professional experts and a timetable before arbitration proceedings are triggered, ultimately enhancing the parties' opportunity of early settlement.

³⁶ Articles 1125 and 1127 of the Spanish Civil Code.

³⁷ Articles 7 and 1258 of the Spanish Civil Code.