DR clauses in contract

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This paper was prepared and settled jointly by the members of ADRAC.

What are dispute resolution clauses (DR clauses)?

DR clauses in a contract are the steps that parties agree in advance, that they will follow if a dispute occurs during the contract. They commonly appear but it is a notable feature of these clauses that they are not negotiated to meet the needs of the particular contract but rather appear in the contract as a 'standard clause'. The result is often a clause which does not fit the contract, the parties or the likely forms of dispute that arise from the contract.

ADRAC considers that much can be done to improve the effectiveness of DR clauses.

Why use DR clauses rather than just go to court?

Although litigation in the courts can be slow and expensive there are specialist courts that can act with speed and expertise especially in the commercial field. Parties may nevertheless prefer to avoid litigation. They may wish to retain the flexibility of commercial agreement that courts cannot provide. Courts determine disputes by applying the law; they must do that regardless of the commercial interests or opportunity that may exist for both parties were they to renegotiate. Courts do not seek to redesign the contract or even return it to the wishes of one party or the other. Courts apply legal rules to a disputed contract. Furthermore, the courts must conduct their work in open public hearings. DR clauses allow parties to retain control over not just the dispute and the commercial flexibility available from private negotiated agreement and not available from Courts, but to do so privately.

Why do parties use DR clauses?

DR clauses in contract provide parties with clear and quick pathways to manage disputes that could damage or terminate a contract and the commercial relationship that produced it. DR clauses can preserve commercial relationships, ensure all relevant persons know a dispute exists and what it is (useful when one or both parties are large organisations) and prevent a premature resort to litigation, when an effective and speedy commercial or other outcome of the dispute is achievable.

A DR clause can cover the risk of unnecessary termination of the contract or court battles about a contract that is fundamentally sound. It can prevent the descent of a dispute into a fight. It prevents damage to productive commercial relationships and reasonable communication. Pre-contractual negotiations cannot cover all contingencies. DR clauses allow the unknown or the oversight to be managed.

DR clauses in a contract can give the parties alternatives to the costs and delays of litigation and preserve the efficacy of a good commercial or other contractual arrangement.

What do DR clauses contain?

Well-negotiated DR clauses can provide for notice of dispute, negotiation, mediation, arbitration or some other structured method of bringing the parties to resolution.

A requirement in a DR clause to negotiate may involve notifying a dispute to a particular person or officer in the other organisation. The provision may enable discussions to occur within a commercially effective timeframe. Such provisions are sometimes referred to as elevation clauses; they allow more senior officers or designated ‘dispute officers’ to become aware of and promptly manage a dispute that might otherwise ‘languish’ to become larger problems later.

Other DR provisions may identify some familiar type of dispute common in contracts of that type and make special provisions for them. Disputes about invoicing issues, delivery scheduling or technical matters (compliance with specifications, chemical, engineering or building matters) may be referred to arbitration. In that way the parties agree that the outcome shall be as found by an arbitrator or some agreed assessor.

Most forms of commercial dispute could be referred to arbitration or expert determination.

A DR clause may provide that other disputes especially those that require a speedy outcome, are referred to mediation to see if the parties can come to their own agreement, before resorting to other more structured forms of DR. Those other forms of DR could be next, or alternative steps, set out in the DR clause, or to litigation.

Are there time limits?

Most good DR clauses need to be negotiated at the time of the formation of the contract to fit the commerciality of an agreement and therefore seek to have a dispute addressed and resolved in timeframes likely to minimize commercial damage.

Periods for negotiation, arbitration, mediation, expert determination or other forms of DR must generally be specified (to avoid uncertainty), but the limits chosen will be those the parties negotiate to meet the needs of their particular contract. Contracts involving perishable items or high value services may have urgent timeframes. Other forms of contract especially long term contracts may provide for the ‘collection’ or gathering of dispute to enable them to be dealt with together.

Do DR clauses exclude access to courts?

Generally speaking the parties can agree in advance to manage dispute in a way the parties choose. Ultimately the jurisdiction of the court over a particular contract is a legal matter and courts can be asked to step in or determine dispute where a contract fails or a DR clause fails. Parties cannot agree to fully oust the jurisdiction of the courts to the exclusion of the court justice system. Nevertheless the courts will enforce the binding nature of DR clauses, the most obvious being the enforcement of a clause that requires a DR process to be undertaken before litigation. Courts may also require parties to pursue DR processes that are required by legislation. A common example relates to conciliation but there are others in the family dispute field.

The parties may choose to have certain types of dispute determined by arbitration or expert determination rather than the courts. The benefits to the parties are privacy, protection of commercial information and relationships, speed and cost. Parties can agree in advance for example, on the timeframe for an arbitration or expert determination but cannot do so for court hearings.

Can DR clauses produce binding outcomes?

Parties can agree beforehand that they will be bound by the outcome of a DR process but the outcome would usually be binding in any event. For example the outcome of arbitration involves a hearing that is usually binding and excludes further action. Parties can agree, in advance, that expert determination will bind the parties. Mediation provisions may require parties to choose a mediator and attend mediation in good faith, but cannot 'require' the parties to reach agreement. A mediator may encourage and assist the parties to reach agreement but cannot make them do so. If however the parties do come to an agreement, the agreement is a contract and the usual rules apply, making the contract binding. See Enforceability of ADR clauses in contract.

What are common problems with DR clauses?

The single largest problem with DR clauses relates to the insertion of 'standard' DR clauses without adapting the clause to the demands of the contract and the relationship between the parties. Ironically DR clauses are often included in a contract without sufficient or, indeed, any negotiation. ADRAC considers that a change in contract negotiation practice to include specific discussion about the appropriate form of DR clauses will have two beneficial effects:

1. The parties will by the nature of the exercise, come to consider where disputes could occur and that will cause a review of those areas of the contract that might prevent such disputes;
2. The DR clauses included in the contract will be tailored to meet the specific demands of the contract, the needs of the parties and the likely commercial consequences of a dispute.

When a dispute occurs the DR clauses may not have been (i) structured to meet timeframes required by the nature of the contract; (ii) adapted to the types of dispute that can commonly or predictably occur; and/or (iii) tailored to the dispute preferences of the parties. Some parties may benefit from elevation clauses that lift disputes quickly from the shop floor to management level. Some parties may prefer immediate referral of technical questions to expert determination. Most parties may prefer to be informed that the other party considers that a dispute exists. Some parties may agree to move straight to a particular court. ADRAC is of the view that consideration of practical issues of this type at the time of contact formation will have beneficial effects on the utility of the DR clauses negotiated.

In 2013 the National Alternative Dispute Resolution Advisory Council (NADRAC), was in the process of producing a report on DR Clauses in Government Contracts. It consulted with government lawyers, both AGS and in-house lawyers and widely in the private profession with legal firms in the top and mid-tiers and smaller firms involved in contractual work. Although abolition of NADRAC prevented completion of the DR clauses project, many of the members of NADRAC involved carried their experience of the project to ADRAC. It was the experience of those members that a good step to progressing the effectiveness of DR clauses was that the clauses be actively discussed with clients and among lawyers and be negotiated in the contract formation phase taking into account the features of the contract in question.

ADRAC plans to publish at a later stage a guide to the creation of DR clauses.

What forms do DR clauses take?

DR clauses take two principal forms. The first is the simple (usually single level) DR provision. The second is the multi-layered process which may prescribe various levels of DR before some particular final process (such as the courts or arbitration) is specified to determine an outcome to the dispute.

A simple clause may require that if a dispute among the parties is not resolved by agreement with 21 days of notification, it shall be submitted to an arbitrator (to be found from a specified course), with the arbitration to be completed within a specified time. Another form of single layered clause might require the parties to make contact

at certain levels (e.g. the CEO of the smaller organisation with the production manager of the larger organisation) and failing agreement from that contact to use a mediator for a period not exceeding a week before resort to litigation.

Multi-layered clauses usually have as a goal achieving either a resolution by agreement or an imposed determination within a commercial timeframe. It will step up the intensity of the dispute resolution process in a way that responds to the contract but pursues a final outcome at each stage.

An example of a multi-layered process designed to manage dispute in a large and complex contract might have the following steps:

1. Where a party considers that a dispute exists in a particular area of the contract (penalty claims, quantum of supply, obligation to repair etc), the party shall serve notice within a specified period of an event occurring, on a specified office holder of the other party/parties.
2. Upon receiving that notice the receiving party shall within a specified period arrange to meet to seek agreement.
3. If no agreement is reached between the parties, the parties might agree to appoint a mediator from an agreed list or failing such agreement might agree to submit to the decision of a nominee who shall appoint a mediator, and conduct a mediation which would commence and complete within specified periods subject to agreements to enable extended time to complete mediation.
4. Failing agreement in mediation the parties agree that the matter shall be determined by binding arbitration (or expert evaluation if applicable).

The use of multi-layered clauses may produce a speedy outcome and failing negotiation or mediation, the benefits of arbitration remain available.

Are there model DR clauses?

Model clauses abound and are freely available. It remains necessary in every case however to tailor the clauses to fit the needs of the parties to the contract.

NADRAC produced a model clause in its report The Resolve to Resolve – September 2009.

The Model Clause Prepared by NADRAC was based on a precedent prepared by the NSW Law Society. The latest Law Society of NSW model clause is at p. 36 of its 'Dispute Resolution Kit' Dec 2012.

There are many other examples of available DR clauses:

- North American Free Trade Agreement (covering USA, Canada and Mexico)
- ICC standard arbitration clauses