Enforceability of ADR clauses in contract

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

Whilst the courts have identified numerous requirements for DR clauses to be enforceable, there is no accepted exhaustive 'list' of such requirements in Australia.

In considering this topic it is important to recall the distinction between DR clauses generally – which can include various steps such as direct negotiation – and ADR clauses, which usually, if not always, involve a disinterested third party.

It is possible for a DR clause to include a combination of DR and ADR processes (multi-tiered DR clauses are increasingly common in large-scale commercial contracts where there is a strong mutual interest in favour of completion).

In relation to enforcement of DR/ADR clauses in contracts it is also important to bear in mind the distinction between mandatory and consensual DR/ADR. Conceptually, ADRAC considers that DR/ADR clauses in contracts give rise to consensual DR/ADR processes – even if the specific context involves one disputant seeking to enforce, and another disputant seeking to resist, participation in the DR/ADR process. This is because the source of the so-called 'obligation' to participate is, at the end of the day, the voluntary agreement reached between the parties.

Minimum requirements for enforceability

It is generally accepted that pre-conditions to enforceability include the following:

- the clause must operate as a postponement of a party's right to commence legal proceedings until the relevant ADR process is concluded, rather than as a prohibition against a party having such recourse.[1]
- the clause itself should be both 'certain' and 'complete' with respect to various matters:
    - the specification of the ADR process must be certain and clear
    - the 'framework' for selection of the ADR practitioner (such as the mediator) must be sufficiently certain
    - the framework for deciding the ADR practitioner's remuneration should be certain
    - the clause should not involve a mere 'agreement to agree'.[2]
    - indeed, there cannot be any stage in the process where agreement is needed on some course of action before the process can proceed
    - generally speaking, a DR/ADR clause should set out in some detail the process which is to be followed – or incorporate these by reference.

These various requirements derive from the fact that if a DR/ADR clause depends on agreement as to a way forward, and the parties cannot agree on how to proceed, the clause will amount to a mere agreement to agree.

The precise vice which infects a mere agreement to agree has not been completely resolved in Australia. Sometimes it is said to be attributable to a lack of completeness; sometimes it is said to derive from a lack of certainty. In truth, incompleteness (at least of a kind which the courts will not overcome by implication of terms) leads to uncertainty. A mere agreement to agree may be regarded as being incomplete, vague, and meaningless.

It may also be regarded as defective for another, quite independent, reason. How can any court compel contractual parties to agree on something if they conscientiously disagree? A court will decline to enforce an agreement to agree because it is simply unable to do so. It will not grant relief or remedies that it is unable to enforce.

However, there is a difference between a mere agreement to agree, and a DR/ADR clause which specifies the means of overcoming any disagreement between the disputants on the way forward – such as selection of the DR practitioner by a nominated third party if the disputants cannot agree. Courts will enforce the latter.[3] What is enforced is not a mere agreement to cooperate, but participation in a process from which consent might come.

Is an obligation of 'good faith participation' enforceable?

It is now clear that a contractual agreement to negotiate in good faith may be enforced in Australia, contrary to the position which generally obtains in the UK. As to the position in the UK see *Walford v Miles* [1992] 2 AC 128 wherein it was held that 'good faith' clauses are unenforceable for incompleteness. In eschewing this position as part of the law of Australia, Allsop P stated as follows in *United Group Rail Services Ltd v Rail Corporation New South Wales* [2009] NSWCA 117 (with Ipp and Macfarlan JJA agreeing):

> Nor, with respect, do I find the views of Lord Ackner in *Walford v Miles* persuasive. An obligation to undertake discussions about a subject in an honest and genuine attempt to reach an identified result is not incomplete. It may be referrable to a standard concerned with conduct assessed by subjective standards, but that does not make the standard or compliance with the standard impossible of assessment. Honesty is such a standard: cf *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378 and *Twinsectra Ltd v Yardley* [2002] 2 AC 164 … **If what is required by the voluntarily assumed constraint is that a party negotiate honestly and genuinely with a view to resolution of a dispute with fidelity to the bargain, there is no inherent inconsistency with negotiation, so constrained.** (at [65]) (emphasis added)

Allsop P in *United Group Rail Services* went on to reject the proposition that 'good faith' was too uncertain to have meaning. His Honour stated at [72]:

> As a matter of language, the phrase "genuine and good faith" in this context needs little explication: it connotes an honest and genuine approach to the task.

ADRAC's position on good faith provisions in contracts

ADRAC welcomes the approach taken by Allsop P in *United Group Rail Services Ltd v Rail Corporation New South Wales* [2009] NSWCA 117, which has much to commend it.

When contracting parties are stipulating standards of participation in DR/ADR processes, ADRAC recommends that they do so by using expressions with a generally understood meaning, such as 'genuine', 'reasonable', 'good faith', and 'best endeavours'. Moreover, ADRAC notes that the law in this area is not entirely settled (Allsop P in *United Group Rail Services* allowed for the possibility that his views on good faith may have differed from those of Giles J in *Elizabeth Bay Developments Pty Ltd v Boral Building Services Pty Ltd* (1995) 36 NSWLR 709 and *Hooper Bailie Associated Ltd v Natcan Group Pty Ltd* (1992) 28 NSWLR 194).

The manner of enforcing DR clauses

Generally speaking, courts will not make an order for specific performance of a DR clause. That is, courts will generally refrain from directly compelling participation in an agreed DR/ADR process. This is because judicial supervision of performance pursuant to a DR/ADR clause is generally regarded as inapt and/or untenable.[4]

Rather, courts will indirectly enforce DR/ADR clauses by resorting to their inherent or implied powers to prevent abuses of their processes by ordering stays on proceedings, or by adjourning proceedings, until the agreed process set out in the DR/ADR clause has been completed.[5]

How structured/detailed should a DR/ADR clause be?

Courts themselves recognise that enforcement of a DR/ADR clause should not depend on exhaustive prescriptive at an overly-granular level. It has been held that if specificity beyond essential certainty were required, the dispute resolution procedure may be counterproductive as it may begin to look much like litigation itself.[6]

Difficulties can arise from provisions which include references to ‘guidelines’ which apply to the nominated DR/ADR process. How are such ‘guidelines’ to be taken into account or applied?

Possible severance of a vague provision in a clause?

When a court enforces a DR/ADR clause, it does so by reference to ordinary principles of contract law. One such principle concerns severance, whereby a vague or uncertain part of a clause may be ‘excised’ from the contract. Courts will not permit severance unless the remainder of the clause, following severance, is certain and complete.

Supplementation of a DR/ADR clause

In some circumstances, courts will supplement a DR/ADR clause in order to give it business efficacy, or to make express what must have been agreed, impliedly, by the contracting parties. Again, it does so by application of conventional principles of contract law, rather than rewriting the agreement reached between the parties.

General trend in interpreting DR/ADR clauses

Courts have acknowledged a ‘general trend’ towards construing DR/ADR clauses in a way that makes them ‘enforceable’.

This was expressed by Vickery J in *WTE v RCR* wherein his Honour stated:

> The trend of recent authority is in favour of construing dispute resolution clauses where possible, in a way that will enable those clauses to work as the parties appear to have intended, and to be relatively slow to declare such provisions void either for uncertainty or as an attempt to oust the jurisdiction of the court.[7]

Warren J also gave emphasis to giving effect to DR clauses where possible in *Computershare Ltd v Perpetual Registrars Limited (No 2)* [2000] VSC 233:

> Furthermore, where parties have made a special agreement requiring them to address a path to a potential solution there is every reason for a court to say such parties should be required to endeavour in good faith to achieve it. In these

> circumstances the court does not need to see a set of rules layed [sic] out in advance by which the agreement, if any, between the parties may in fact be achieved. (at [15])

Allsop P in *United Group* supported this tendency towards giving DR clauses effect when it is possible to do so. His Honour stated:

> The public policy in promoting efficient dispute resolution, especially commercial dispute resolution, requires that, where possible, real and enforceable content be given to clauses such as cl 35.11 and cl 35.12 … (at 641)

ADRAC welcomes this trend.

However, an issue arises as to why the public policy in promoting efficient dispute resolution should have some special force or application in relation to commercial dispute resolution. ADRAC considers that DR/ADR clauses in the arrangements governing participation in various industries, sports, arts, the education sector, employment agreements, and many other fields of human endeavour are deserving of 'at least equal' enforcement before resort to courts of law to resolve disputes.

The way forward: wider use of DR/ADR clauses

DR/ADR clauses can be a very effective way of resolving disputes – even in a context where one of the parties resists enforcement of the clause.

ADRAC considers that there is considerable scope for the expansion of DR/ADR clauses in various fields of human endeavour such as industry, sports, the arts, the education sector, and employment.

ADRAC also considers that there has been insufficient attention given to one particular form of DR/ADR clause: namely, a clause which makes provision for appointment of a dispute manager who will (i) assist the parties to devise a DR regime/process which suits their particular dispute; and (ii) if necessary, give binding directions as to the particular regime/process which is to be put in place in the absence of agreement.

ADRAC would be interested in feedback on this suggestion, and in relation to the issues canvassed above. For instance, would it assist the uptake of DR/ADR clauses if ADRAC, or some other body, were to construct a suite of possible clauses for consideration by prospective disputants?

1. *Aiton v Transfield* [1999] NSWSC 996 at [43].

2. *Booker Industries Pty Ltd v Wilson Parking (Qld) Pty Ltd* (1982) 149 CLR 600 at 604; *Coal Cliff Collieries Pty Ltd v Sijehama Pty Ltd* (1991) 24 NSWLR 1 at 17.

3. *State of NSW v Banabelle Electrical Pty Ltd* (2002) 54 NSWLR 505 (Banabelle) at 519; *WTE Co-Generation & Anor v RCR Energy Pty Ltd & Anor* [2013] VSC 314 at [39].

4. See *Hooper Bailie Associated Ltd v Natcon Group Pty Ltd* (1992) 28 NSWLR 194 at 210 (at [26]).

5. See, for instance, observations of Vickery J in *WTE Co-Generation & Anor v RCR Energy Pty Ltd & Anor* [2013] VSC 314; *Aiton v Transfield* [1999] NSWSC 996.

6. *WTE Co-Generation & Anor v RCR Energy Pty Ltd & Anor* [2013] VSC 314 at [33]-[34].

7. *Straits Exploration (Australia) Pty Ltd v Murchison United NL & Anor* (2005) 31 WAR 187 (Martin J) [14].