Parties embarking on a new commercial venture together are often positive about their relationship and focused on making it work to their mutual benefit. Understandably, they can be reluctant to spend much time planning for what should happen if matters later turn sour. However, it is vital to give some thought in advance to the dispute resolution clauses in your contract to ensure that there is an appropriate procedure in place to deal with disagreements in a structured and proportionate way which gives the parties the best chance of resolving them as quickly and cost efficiently as possible. In this article we look at some of the key considerations when drafting an effective dispute resolution clause.

- What is the purpose of a dispute resolution clause?
- How important is it to get the dispute resolution clause right?
- What should a dispute resolution clause cover?
- What methods of dispute resolution are available?
- What is alternative dispute resolution (ADR)?
- What are the advantages and disadvantages of (non-binding) ADR?
- What is an escalation clause?
- Are parties bound to follow all steps of the agreed dispute resolution process, or can they go straight to litigation / arbitration?
- Is it possible to provide for different dispute resolution methods for different disputes?
- Is there anything else a dispute resolution clause should cover?
What is the purpose of a dispute resolution clause?

A dispute resolution clause sets out the process by which the parties intend to resolve any disputes which may arise out of their contract. It may cover both contractual disputes (e.g. a difference of opinion as to the meaning and effect of a particular contract clause) and non-contractual disputes (e.g. where party A alleges party B was negligent in its performance of the contract). There are various different methods of dispute resolution, one or more of which may be set out in a dispute resolution clause.

How important is it to get the dispute resolution clause right?

It is important to ensure that the dispute resolution clause is clear, concise, and workable. Courts and tribunals are generally keen to uphold terms the parties have agreed, including agreements as to the method of dispute resolution. Therefore, if the dispute resolution clause is unclear, ambiguous or overly convoluted, there is a risk of uncertainty about how it operates, and the possibility of time-consuming and costly satellite disputes as to its meaning and effect.

What should a dispute resolution clause cover?

The precise contents of a dispute resolution clause will depend to some extent on the form of dispute resolution the parties choose (as to which, see further below), but key considerations which should be addressed in dispute resolution provisions include:

- Which country’s laws will govern the contract and be applied in any disputes arising out of it (the governing law)?
- Who should apply the governing law and make a binding decision on any dispute? This is set out in a jurisdiction clause (for litigation) or an arbitration agreement (for arbitration).
- What steps, if any, must the parties take to resolve their dispute before referring it for a binding decision?

What methods of dispute resolution are available?

There are many different methods of dispute resolution, but they broadly fall into one of two camps: non-binding or binding.
Non-binding forms of dispute resolution focus on the parties reaching a consensual resolution. Examples include:

- **Negotiation** - this is sometimes split into two separate phases - first, negotiations between representatives of the parties who are responsible for operating a contract on a day to day basis and then, if that proves unsuccessful, negotiations between senior executives with authority to settle the dispute. In some cases negotiations may also be attended by the parties' lawyers.

- **Mediation** - a process whereby an independent third party mediates between the parties to explore areas for potential compromise. Ultimately it is still for the parties to decide whether they can agree a resolution to their dispute.

- **Early Neutral Evaluation** - an impartial evaluator gives the parties a view on the merits of their respective cases, to help them assess strengths and weaknesses and inform negotiations, or potentially subsequent binding dispute resolution proceedings.

In **binding** forms of dispute resolution, the parties submit their dispute to a third party decision maker (e.g. a judge or arbitrator) to make a decision which will be binding upon them (subject to any agreed appeal process). The most common alternatives are:

- **Litigation** - the most commonly used and perhaps best understood method of dispute resolution, using the national courts to determine the dispute. Although the courts are taking active steps to manage the cost and duration of litigation, decisions are subject to appeal on a point of law, so it is possible that it may take many years to reach a final, binding decision.

- **Arbitration** - a private process where the parties agree that their disputes are to be resolved by one or more arbitrators instead of the court. Arbitration can be entirely domestic, but it is most often used to resolve disputes with a cross-border dimension, either because arbitration awards can be easier to enforce internationally than court judgments, or because parties may be wary of submitting to the jurisdiction of a foreign court. Arbitration is generally more flexible than litigation, as the parties have scope to choose their arbitrator(s) and shape the procedure to be adopted.

- **Expert Determination / Adjudication** - in these methods, a neutral third party makes a determination which is binding on the parties and can then be enforced through the courts if necessary. These processes are typically quick, often sought in respect of a discrete issue, and are presided over by industry experts, so may be suitable when the parties need a quick decision in order to continue business, whereas litigation and arbitration are generally much more drawn-out processes.

**What is alternative dispute resolution (ADR)?**
In the UK, ADR usually refers to non-binding forms of dispute resolution, geared towards resolving a dispute without recourse to binding determination by litigation or arbitration. In other jurisdictions though, including North America, ADR refers to any method of dispute resolution other than litigation - so arbitration is considered to be a form of ADR (even though it produces a binding award which the parties cannot generally appeal in the national courts).

**What are the advantages and disadvantages of (non-binding) ADR?**

Non-binding ADR can be a shortcut to resolution, and produce time and cost savings compared to the parties going straight to a more intensive form of binding dispute resolution. This is particularly the case where the input of a neutral third party with an objective view provides the parties with a fresh perspective on a dispute, and can help to break a stalemate between parties whose positions may have become entrenched.

Parties do, however, need to be aware that for ADR to stand a good chance of success, they need to approach it with an open mind and prepare adequately, rather than treating it as a 'tick-box' exercise. In turn this means that there are incremental costs to engaging in ADR (including both the parties' legal costs and the fees of the neutral third party), so if unsuccessful in determining the dispute or narrowing the issues, ADR will add to the overall costs of resolving the dispute rather than save them.

**What is an escalation clause?**

Escalation clauses are multi-tiered dispute resolution clauses, which provide for a dispute to be escalated usually from relatively informal discussions between the parties through gradually more formal processes until the dispute is finally resolved one way or another.

A tiered dispute resolution clause may, for example, provide for the parties to negotiate for a specified period (e.g. 30 days from notification by one party to the other of the dispute). If the negotiations are unsuccessful, then the parties might progress the matter to a non-binding form of ADR (e.g. mediation), and in the absence of a resolution, ultimately escalate the dispute to a binding dispute resolution process for a decision.

Tiered dispute resolution clauses may include all or only some of these stages. It is perfectly possible, for example, to go straight from negotiations between the parties, to litigation (although see the warning below), or to use more than one form of ADR. No one size fits all, and there are many factors which will determine the appropriate escalation process, including the value of the contract, the type of disputes likely to arise, the cost of the dispute resolution
Are parties bound to follow all steps of the agreed dispute resolution process, or can they go straight to litigation / arbitration?

This depends very much on the wording of the clause; the parties may express that a particular step in the process is optional. However, it is important to note that the courts of England & Wales expect parties to attempt to resolve their dispute through ADR, and there may be costs sanctions for a party who fails to engage in ADR, even if that party ultimately succeeds at trial - see our article "do I have to consider mediation?" Therefore, even if parties are not contractually bound to follow every step of the dispute resolution clause, they would do well to engage in ADR in case their dispute ultimately appears before the courts of England & Wales.

Is it possible to provide for different dispute resolution methods for different disputes?

Yes. Whilst it is not always possible for the parties to know in advance what sort of disputes may arise, in some cases they will be able to anticipate certain discrete issues, such as disputes over valuation or technical points. The parties could for example agree for such disputes to be referred to expert determination so that they can be resolved quickly and cost-effectively, while agreeing to refer more substantial disputes to litigation or arbitration.

Is there anything else a dispute resolution clause should cover?

Something else to consider, particularly in international contracts, is appointing a service agent in the jurisdiction where court proceedings would be commenced. This means that the parties agree in their contract that court legal proceedings may be served on their nominated representative, the service agent. This can avoid potential disputes about whether proceedings have been effectively served on a party resident in another country. For discussion on the use of service agents, see our article "All about service".

Summary

Although it can feel pessimistic to consider the "what ifs" when drafting dispute resolution
clauses at the start of a business relationship, consideration of these points should not be thought of as admitting the possibility of failure, rather as giving your contract the best chance of success. The appropriate dispute resolution clause will put you in the best position to work through disputes in a constructive and cost-efficient way if they do arise, and also give you the best chance of maintaining an amicable relationship if desired.
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