

## Dispute resolution clauses and the importance of drafting

### Introduction

A dispute resolution clause is an agreement within a contract which sets out the mechanism for the resolution of disputes between the contractual parties. The scope of that agreement is determined in the drafting of the clause. When agreeing such a clause, there is an increasing trend amongst commercial parties engaged in international business to provide for a mechanism other than litigation. Often through bitter experience, many commercial parties consider national court litigation to be too public, expensive, lengthy and/or damaging to the long term relationship of the parties.

An increasingly popular alternative for commercial contracts is arbitration. Amongst other benefits, arbitration provides the privacy that commercial parties seek when resolving disputes and, whereas difficulties may be encountered when attempting to enforce national court judgments in other jurisdictions, arbitral awards may be enforced in any of the 144 signatory states of the New York Convention.<sup>1</sup> Other mechanisms commonly found in international commercial contracts include adjudication and expert determination. Each of these has its respective merits and may be relied upon in isolation or as part of a multi-tiered mechanism.

Dispute resolution clauses are, however, often considered to be one of a number of standard boilerplate clauses included towards the end of modern commercial contracts. Sometimes, those involved in the negotiations often pay less attention to these clauses than ought to be the case. A lack of attention to the drafting of a dispute resolution clause may lead to defective drafting and the clause becoming unworkable, or "pathological".

A recent case in the English High Court, *Ericsson AB v EADS Defence & Security Systems Ltd.* (the "**Ericsson Case**"),<sup>2</sup> has highlighted this very issue and the consequences of a poorly drafted dispute resolution clause. In this newsletter, we consider pathological dispute resolution clauses and review the Ericsson case in greater detail.

### Pathological Dispute Resolution Clauses

A dispute resolution clause may be termed a pathological clause when it contains one or more defects in its drafting which prevent the intended operation of the clause.<sup>3</sup> In circumstances where there is such a defect in the clause, the party attempting to initiate the dispute resolution mechanism prescribed will have the burden of proving that the defect can be cured through the proper construction of the clause. Where it is determined that the defect has rendered the clause incapable of being performed and unenforceable, the parties will be deprived of the benefits their selected dispute resolution mechanism and forced into the national court litigation which they had sought to avoid.

The aim when drafting a dispute resolution clause should therefore be to ensure that it is clear, internally consistent, workable and reflects the intentions of the parties. Unfortunately, this aim is not always achieved and the following are examples of defective drafting upon which arbitral awards and national court judgments have been handed down:

- "all disputes shall...be resolved by the courts of the People's Republic of China **or** be arbitrated in the People's Republic of China" (emphasis added) - provides for both arbitration and national court litigation;<sup>4</sup>
- "[t]he parties **may** refer any dispute to arbitration" (emphasis added) - provides for arbitration as an option only;<sup>5</sup> and

<sup>1</sup> The Convention of the Recognition and Enforcement of Foreign Arbitral Awards 1958.

<sup>2</sup> [2009] EWHC 2598 (TCC).

<sup>3</sup> It should be noted that the focus of this newsletter is on the drafting of an otherwise valid dispute resolution clause and not whether any formal requirements for validity have been satisfied. In the context of arbitration agreements, such requirements for validity include those set out in Article II of the New York Convention and Clause 5 of the English Arbitration Act 1996.

<sup>4</sup> High Court of Hong Kong in *William Company v Chu Kong Agency Co. Ltd.* [1995] HKLR 139.

<sup>5</sup> Court of Appeal of Ontario in *Canadian National Railway Co. v Lovat Tunnel Equipment Inc.* (1999) 174 D.L.R. (4th) 385.

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- "[any] dispute or difference...shall be arbitrated...in accordance with the rules of procedure of the **International Commercial Arbitration Association**" (emphasis added) - provides for an arbitral institution which does not exist.<sup>6</sup>

## The Ericsson Case

### The Facts

In 2007, EADS was appointed to provide an emergency communications system to the Fire and Rescue Service in England, known as FiReControl. EADS sub-contracted to Ericsson the development and supply of software and related support services. A key deadline was said to be the 2012 London Olympic Games. In the second half of 2009, EADS became concerned that delays it attributed to Ericsson might impact upon that deadline, the parties exchanged correspondence on the issue and EADS served a notice of material default upon Ericsson.

The dispute resolution clause in the sub-contract provided that the parties "**shall** first consult in good faith in an attempt to come to an agreement" (emphasis added). In the event that consultation should fail, the sub-contract provided that either party:

- "**may** give notice of its intention to proceed to mediation ... **or** to refer the matter to adjudication" (emphasis added).

Purportedly in accordance with the above, Ericsson first gave notice of mediation shortly before EADS's notice of material default. EADS accepted. Then, shortly after the notice of material default, Ericsson gave a second notice - but on this occasion of adjudication. Both parties made applications to the English courts in relation to Ericsson's notices, one of which was an application by EADS for an injunction to prevent adjudication on the basis that the parties had already agreed to mediate the dispute.

### The Decision

On the issue of the construction of the dispute resolution clause, the English High Court judge, Mr Justice Akenhead, held that:

- "One needs to construe dispute resolution provisions particularly in commercial contracts in a way which would make sense to commercial parties".

In construing the dispute resolution clause in the sub-contract, it was held that "*it is open to either party on a given dispute either to mediate or to adjudicate or to do both.*" Mediation and adjudication are different forms of dispute resolution, and the use of the word "*may*" rather than "*shall*" meant that both forms were available options rather than mutually exclusive alternatives.

Moreover, it was held that "*it would have been easy for the parties to specify an absolute requirement that the parties have good faith negotiations first, then mediation, then adjudication followed by the final form of dispute resolution (court or arbitration)*". The proper construction of the clause was that the parties had intended a flexible mechanism.

For the above reasons, Mr Justice Akenhead dismissed EADS's application for an injunction to prevent adjudication.

## Practical Advice and Conclusions

The Ericsson Case and the other examples above emphasise the importance of clear drafting in dispute resolution clauses. In this regard, sufficient time should be allowed in negotiations for careful consideration of the dispute resolution mechanism to be included in the contract. Where the subject matter of the contract is of significant commercial value, expert advice should be sought to ensure that pathological defects are avoided and the dispute resolution mechanism is effective in the manner intended by the parties. This should lead to the speedy and effective resolution of disputes and, to the extent possible, the preservation of relations between the parties.

On a separate note, the Tokyo Dispute Resolution practice is delighted to announce the promotion of Gavin Margetson to the partnership as of 1 May 2010. Gavin's profile can be found at [www.herbertsmith.com/People/GavinMargetson.htm](http://www.herbertsmith.com/People/GavinMargetson.htm).

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<sup>6</sup> High Court of Hong Kong in *Lucky-Goldstar International (H.K.) Limited v NG Moo Kee Engineering Limited* [1993] 2 HKLR 73.