COMMENTARY

TIERED ADR CLAUSES IN INTERNATIONAL TRANSACTIONS: AN APPROACH TO ENFORCEABILITY

*Dyalá Jiménez Figueres**

INTRODUCTION

In a recent decision, *Cable & Wireless PLC v. IBM United Kingdom Ltd.*,[1] Justice Colman of the High Court of England and Wales (the Commercial Court) held that the parties' agreement to refer their dispute to ADR[2] was enforceable. Accordingly, the court stayed the proceedings and ordered the parties to refer their claims to ADR. Justice Colman arrived at what he described as "the appropriate course"[3] using a path that could serve as an example to arbitrators faced with objections to arbitration based on the other party's failure to participate in ADR proceedings prior to submitting the case to arbitration.

The case concerned a Global Framework Agreement whereby the defendant IBM was to supply claimant Cable & Wireless (C&W) with worldwide information technology services. This agreement provided for an ADR procedure. Clause 41 of the agreement provided:

> 1. The Parties shall attempt in good faith to resolve any dispute or claim arising out of or relating to this Agreement or any Local Services Agreement promptly through negotiations between the respective senior executives of the Parties who have authority to settle the same pursuant to Clause 40.[4]
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> 2. 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 (CEDR). However, an ADR procedure which is being followed shall not prevent any Party or Local Party from issuing proceedings.

* The author is Special Counsel for ADR & Expertise of the International Chamber of Commerce (ICC). The author's views do not engage the ICC or represent the views of the ICC.

[1] Cable & Wireless PLC v. IBM United Kingdom Ltd. [2002] EWHC 2059 (Comm).

[2] As used in this article, ADR refers to any mechanism other than arbitration in which the parties seek the involvement of a neutral third party with the view toward resolving a dispute.

[3] Cable & Wireless PLC [2002] EWHC 2059 (Comm) at 11.

[4] Clause 40 describes an escalation process of negotiation between the parties' executives.

A dispute arose in relation to the quality and price of the information technology services provided by IBM, specifically whether these services complied with a "benchmarking process" established in the parties' agreement. The benchmarking provision called for an independent third party to compare the cost and quality of the furnished services against that in the industry. If IBM's services were not compatible, then IBM was to come up with a plan acceptable to C&W to remedy the lack of compatibility. When the benchmarker's report indicated that IBM's prices were not compatible, IBM challenged the report's validity. Instead of seeking settlement through and ADR procedure as provided in the clause, C&W applied to the court for an interpretation of the benchmarking provision. IBM applied to the court for a stay of proceedings so that the parties could comply with paragraph 2 of the Agreement's ADR clause. IBM also filed an application challenging the benchmarker's report.

The first section of this article looks at how Justice Colman analyzed the enforceability of the ADR clause. The second section discusses the remedy issue. Finally, the last section discusses the potential influence of the decision on both parties and arbitrators in international arbitration involving tiered dispute resolution clauses.

I. ENFORCEABILITY OF THE ADR CLAUSE

IBM alleged that because the claims fell within the scope of clause 41 of the Agreement, the court should stay the proceedings to allow the ADR procedure to take its course. C&W maintained that the ADR clause was unenforceable because it lacked certainty. It also argued that:

(i) an agreement to negotiate was not enforceable under English law,
(ii) the last sentence of paragraph 2 of clause 41 showed that the parties' mutual intention was for the ADR clause not to have binding effect,
(iii) it would be inequitable for the court to stay the proceedings when IBM had commenced separate legal proceedings, thereby violating the allegedly binding ADR procedure, and
(iv) IBM had made this application belatedly.

Justice Colman first determined that the ADR clause was enforceable under the law of the United Kingdom. First, he addressed C&W's argument that the parties did not intend binding ADR. Examining this issue from a purely contractual perspective, he held that, based on the structure of clauses 40 (which called for a negotiation procedure) and 41, it was clear that the parties' mutual intention was to use litigation as a last resort. He explained:

> [a]lthough not expressly referred to, [the last sentence of clause 41.2] appears to be designed to provide for such eventualities as the need to apply for injunctive or other preservative or interim relief in cases so urgent that they cannot await the outcome of the various stages of negotiation. . . . The mere issue of proceedings is thus not inconsistent with the simultaneous conduct of an ADR procedure, such as mediation, or with a mutual intention to have the issue finally decided by the courts only if the ADR procedure fails.[5]

Second, Justice Colman addressed C&W's argument that the ADR clause constituted an unenforceable agreement to negotiate.[6] He rejected this contention as well, observing that the parties had not only agreed to attempt to resolve their disputes in good faith, they had specified a particular ADR procedure—a procedure recommended by the Centre for Dispute Resolution (CEDR). Justice Colman found that since the CEDR's procedural rules require the parties' active participation, the agreement in the present case involved "engagements of sufficient certainty for a court readily to ascertain whether they have been complied with."[7]

Justice Colman found support for his conclusion in *Dunnett v. Railtrack Plc.*,[8] where an otherwise successful party was penalized by the Court of Appeal for having turned down the judge's invitation to attempt mediation. In that case, Ms. Dunnett sought damages for the loss of her horses, which had wandered onto railway tracks through a gate that Railtrack had replaced. On appeal, Justice Brooke invited the parties to try mediation but Railtrack declined. Although Ms. Dunnett lost the appeal, the court denied Railtrack's application for the costs of the appeal, punishing it for its unjustified unwillingness to try mediation.

In *Hurst v. Leeming*, the court confirmed this pro-ADR attitude in *dicta*, although it denied the claimant's application for costs.[9] Although this case did not deal with ADR clauses, it reflects the adoption of public policy favorable to ADR. Indeed, since 1999, with the enactment of the 'Woolf

[5] Cable & Wireless PLC [2002] EWHC 2059 (Comm) at 7.

[6] C&W submitted as authority Paul Smith Ltd. v. H&S Int'l Holding Inc. [1991] 2 Lloyd's Rep 127, and Courtney & Fairbaim Ltd. v. Tolaini Bros. (Hotels) Ltd. [1975] 1 WLR 297. *See also* Walford v. Miles [1992] 2 A.C. 128 (H.L.) (finding that an agreement to negotiate terms that were "subject to contract" but did not specify a time limit was uncertain and therefore unenforceable).

[7] Cable & Wireless PLC [2002] EWHC 2059 (Comm) at 8.

[8] Dunnett v. Railtrack Plc. [2002] 1 WLR 2434. *See also* Cowl v. Plymouth City Council [2002] EWCA Civ 1935. *But see*, Hurst v. Leeming [2002] EWHC 1051.

[9] *Hurst* [2002] EWHC 1051 at para. 12 (finding the defendant's refusal to attempt mediation was reasonable since the prospect of a mediated settlement was unrealistic). The court held in *dicta* that "[A]lternative dispute resolution is at the heart of today's civil justice system, and any unjustified failure to give proper attention to the opportunities afforded by mediation, and in particular in any case where mediation affords a realistic prospect of resolution of dispute, there [*sic*] must be anticipated as a real possibility that adverse consequences may be attracted."

reforms' or the Code of Procedural Rules (CPR), judges in the U.K. have the obligation of "encouraging the parties to use an alternative dispute resolution procedure if the court considers that appropriate and facilitating the use of such procedure" as part of their case-management duties. The Woolf Reforms aimed at streamlining the judicial process and reducing the costs of litigation. To achieve these goals, they give control of cases to judges, whose overriding objective should be to actively manage their cases.[10]

From this brief overview, it seems likely that U.K. courts will deem an ADR clause enforceable if (i) it was the parties intent to use ADR, and (ii) their agreement includes a sufficiently certain duty to participate in ADR.

II. THE REMEDY FOR NONCOMPLIANCE

In the U.K., "the availability of the remedy [for noncompliance with an ADR clause], whether of a stay or an adjournment or other case management order, must be a matter for the discretion of the court."[11] In this case, Justice Colman decided to adjourn the hearings and ordered the parties to explore mediation regarding all claims related to the agreement. In reaching this decision he took into account (i) the existence of a reasonable prospect of a fruitful ADR procedure, and (ii) the lack of material prejudice to C&W were the proceedings to be stayed.

Justice Colman examined both the nature of the dispute and the scope of the ADR clause. He found that IBM's claim regarding the benchmarking provision was also covered by the ADR clause and was subsidiary to C&W's claim. Thus, it would be good case management for the parties to attempt to mediate all of the claims together. He noted that mediation "is designed to achieve solutions which are mutually commercially acceptable at the time of the mediation."[12]

Judge Colman rejected C&W's argument that it would be unfair to stay the proceedings while acknowledging IBM's application (which challenged the validity of the benchmarker's report) in alleged violation of the ADR clause.[13]

C&W also argued that IBM's application for a stay was submitted belatedly, But Justice Colman held that the timing of the stay presented no material prejudice to C&W, considering the need to decide IBM's application regarding the benchmarking report.

The issues Justice Colman took into account illustrate that, under U.K. law and especially since the Woolf reforms, legal and practical considerations

[10] CPR 1.4.

[11] Cable & Wireless PLC [2002] EWHC 2059 (Comm) at 10 (supported by CPR 26.4 and Commercial Court Guide (2002)).

[12] *Id.*

[13] *Id.* at 2.

should guide judges. An additional factor that may be taken into account by courts in determining the remedy is the punitive amount required to set an example (considering, *inter alia*, the nature of the parties involved). One can guess that this was a consideration in *Dunnet v. Railtrack*, which has been criticized as being overly harsh to Railtrack.[14]

III. THE FUTURE OF ADR CLAUSES IN INTERNATIONAL ARBITRATION

The International Chamber of Commerce ADR Rules (the ICC rules) came into force in July 2001.[15] The ICC also published four suggested ADR clauses that the parties may choose to insert in their agreements.[16] Under the first clause, the parties agree to have the option of seeking an ADR mechanism. Under the second clause, they undertake the obligation to consider, "in the first instance," an ADR procedure. Under the third clause, the parties commit to explore ADR, with an automatic expiration time limit. Finally, under the fourth clause, the parties agree to submit the case first to ADR and should the case not settle within 45 days, to submit it to ICC arbitration. This last clause is a tiered ADR clause.

Tiered ADR clauses (also known as "stepped" ADR clauses) have been in use for some time. Such clauses raise the question of whether the obligation or right to arbitrate should be enforced where a party refuses to comply with an earlier step in the ADR clause (such as the duty to negotiate or mediate).

While there have been no ICC arbitration cases to date in which compliance with the ICC ADR clauses have been disputed, there have been cases where respondents objected to arbitration because of the non-fulfillment of prior amicable dispute resolution efforts agreed to by the parties under similar clauses. For example, in ICC case 4230 (1985),[17] the respondent sought to have the claim declared inadmissible because the claimant disregarded the obligation to seek conciliation prior to requesting arbitration. The arbitral tribunal rejected this objection, finding that the claim was admissible because the language in the clause ("any dispute arising out of the agreement *may* be resolved amicably") did not convey an obligation.

In ICC case 6587 (1993),[18] the tribunal acknowledged that noncompliance with a conciliation process anticipated in the parties' agreement could endanger the admissibility of the claim. But it held that since the parties had engaged in reasonable efforts to reconcile their dispute before the claimant

[14] Tony Allen, *Dunnet v. Railtrack: The Implications*, 29 RESOLUTIONS 6, 7 (2002).
[15] ICC publication No. 809.
[16] The text of the clauses and the ADR Rules can be found at http:// www.iccadr.org.
[17] Emmanuel Jolivet, *Chronique de jurisprudence arbitrale de la CCI: arbitrage CCI et procédure ADR*, GAZETTE DU PALAIS [Gaz. Pal.] 4 (November 16-17, 2001).
[18] *Id.*

submitted the request for arbitration, the ADR clause had been complied with.

Consistent with tribunal decisions to retain jurisdiction where the parties' agreement provided for amicable dispute settlement mechanisms prior to arbitration, the tribunal in ICC case 7983 (1996)[19] determined that noncompliance with an obligation to participate in conciliation first would affect neither the admissibility of the claim nor the jurisdiction of the tribunal. (The tribunal acknowledged that such noncompliance could, in theory, entail contractual liability but did not indicate how that liability translates in practical terms.) The tribunal went on to say that the conciliation clause presupposes the parties' intent to negotiate, a predisposition that ceases to exist when one of the parties submits the dispute to arbitration. This approach reflects the traditional concept of amicable dispute settlement clauses as weak, wishful promises.

CONCLUSION

While the tribunals in the cases discussed above all retained jurisdiction in the presence of tiered clauses, they utilized different approaches. Thus, it appears that a uniform concept as to the nature of the commitments in these clauses (and the effects of their possible violation) does not yet exist. The pressure of national courts, such as in the U.K., and the growing practice in international transactions to utilize mechanisms such as mediation, will certainly give rise to situations where arbitrators are asked to analyze ADR clauses with more rigor. As a result, parties can be expected to increasingly pay attention when drafting dispute resolution clauses, and litigators will no doubt develop more solid arguments regarding the enforceability of such clauses. Indeed, respondents seeking the enforcement of an ADR clause will have to learn how to persuade arbitral tribunals to comply with such clauses and to order adequate remedies (*e.g.*, an order as to costs, a stay of proceedings, or an order declaring a claim inadmissible).

Ideally, arbitrators will develop a consistent practice to provide parties with legal certainty as to the effects these clauses will have on international arbitration. Until such time as a uniform standard is developed by national courts or arbitral tribunals, arbitrators will continue to enjoy considerable discretion when determining whether ADR clauses are binding and what the consequences of noncompliance should be.

The commonsense approach used by Justice Colman of the High Court of England and Wales could serve as a guide to help arbitrators find reasonable solutions and set standards for future cases.

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[19] *Id.*