English court upholds obligation to hold "friendly discussions" before arbitration

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In a recent decision, the English Commercial Court has upheld the enforceability of a clause requiring the parties to seek to resolve a dispute by "friendly discussions" prior to commencing arbitration. The decision contrasts with previous authority regarding the enforceability of agreements to seek to settle disputes by negotiation prior to formal proceedings, but is in line with a possible judicial trend towards the enforceability of good faith obligations under English law.

Multi-tiered dispute resolution provisions

Multi-tiered dispute resolution clauses provide for different stages in the resolution of disputes arising under a contract, typically providing for negotiation, mediation or another alternative dispute resolution process to take place prior to arbitration or litigation. They are popular with commercial parties because of the benefits of significant time and costs savings if a dispute can be resolved at an early stage and the opportunity they offer to preserve commercial relationships.

Contracting parties should be aware that these clauses may well be a mandatory and enforceable condition precedent to arbitration, operating to prevent the parties from having recourse to arbitration until the clause is complied with.

Emirates Trading Agency v Prime Minerals Exports

The risks for commercial counterparties are highlighted by the recent decision of Teare, J in the Commercial Court in *Emirates Trading Agency LLC v Prime Mineral Exports Private Limited* [2014] EWHC 2014 (Comm). In this case, the relevant disputes clause provided "the Parties shall first seek to resolve the dispute or claim by friendly discussion…..If no solution can be arrived at in between the Parties for a continuous period of 4 (four) weeks then the non-defaulting party can invoke the arbitration clause and refer the disputes to arbitration". The contract went on to provide for arbitration in London under the ICC Arbitration Rules.

The case came before the Commercial Court as a result of an application pursuant to section 67 of the Arbitration Act 1996 for an order that the arbitration tribunal appointed to determine a dispute under the contract did not have jurisdiction to do so. This was in circumstances where the tribunal had already decided that it did have jurisdiction since the clause providing for friendly discussions did not create an enforceable obligation (and that even if it did, such obligation had been complied with).

Teare, J held that the obligation to resolve disputes by friendly discussions imports an obligation to do so in good faith and that a dispute resolution clause in an existing and enforceable contract that requires the parties to seek to resolve a dispute by friendly discussions in good faith and within a limited period of time before the dispute may be referred to arbitration is enforceable. This was on the basis that the agreement in such a clause was not incomplete or uncertain; an

obligation to seek to resolve a dispute by friendly discussions in good faith has an identifiable standard of fair, honest and genuine discussions aimed at resolving a dispute.

The judge also considered that the enforcement of such a clause is in the public interest because commercial parties expect courts to enforce obligations that they have freely undertaken and because the object of the agreement is to avoid what might otherwise be an expensive and time-consuming arbitration.

Comment

This decision represents a departure from previous authorities in which some multi-tiered clauses have been considered to be unenforceable because of a lack of certainty. However, Teare, J (who referred in his judgment to recent Australian and Singaporean authorities, as well as the practice of some ICSID tribunals) considered that he could depart from observations made in previous cases, including by distinguishing two Court of Appeal authorities: *Walford v Miles* [1992] 2 AC 128 (in which there was no concluded contract) and *Sul America v Enesa Engenharia* [2012] 1 Lloyds Rep 671 (where in the context of an agreement to mediate prior to arbitration, the parties' rights were not defined with sufficient certainty to create an enforceable obligation to mediate).

The judgment is in many respects a positive development in that it confirms that negotiation provisions agreed by commercial parties are likely to be upheld and given effect to by the English courts rather than dismissed on the basis of uncertainty, thereby following the original intention of the parties who use them.

However, by affirming the enforceability of at least some types of multi-tiered clauses, the decision also reinforces the need for parties carefully to consider at the outset whether such a clause is appropriate and how it should be drafted. While pre-arbitration negotiation may seem a commercially attractive option at the contract formation stage (for the reasons referred to above) when a dispute actually does arise parties often wish to proceed directly to arbitration. A delay may not be desirable or may even damage a prospective claimant's case (for example, where a relevant limitation period may expire imminently, where there are other contractual deadlines to consider, or where the party desires expedited arbitration and/or urgent injunctive relief).

In such cases, unless there has been careful drafting at the pre-contract stage, the existence of a binding and enforceable agreement to negotiate prior to arbitration being commenced may act as an impediment to a prospective claimant. Moreover, if it is ignored, the defendant may raise jurisdiction challenges or seek to resist enforcement at a later stage (particularly in the event of overseas enforcement). That in turn could result in delay and increased costs, together with other commercial inconvenience.

Given the potential risks and the multitude of drafting permutations available, advice should be taken from experienced disputes lawyers prior to agreeing a contract with a multi-tiered clause.

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