

Insights

CASE FLAGS RISK OF UNCLEAR ADR PROCEDURE

Nov 15, 2023

SUMMARY

While main contract suites offer standard dispute resolution clauses, these are often amended in practice. A recent case gives a warning of what happens when such bespoke provisions are not clear.

Many construction contracts, both standard form and bespoke, contain what are referred to as dispute resolution procedures, multi-tiered dispute resolution clauses or alternative dispute resolution (ADR) clauses. There are many names for what is essentially the same type of clause.

These clauses typically require the parties to follow one or more ADR processes before either of them can commence proceedings relating to a dispute, whether in the form of litigation or, as is more common in international contracts, arbitration.

The clause might require a single ADR process such as negotiation or mediation, or it could be more complex, requiring a series of escalating meetings followed by a more formal process such as a dispute adjudication or dispute avoidance board (DAB), or a dispute avoidance adjudication board (DAAB). This can lead to either a binding decision or a recommendation.

Of course, any process in English construction contracts would need to be compatible with the Housing Grants, Construction and Regeneration Act 1996 and the statutory right to refer a dispute to adjudication at any time, which the parties cannot contract out of.

While the parties can include an ADR clause in their contract, they cannot make use of this process as a condition precedent to a referral to adjudication.

The parties should also consider any pre-action protocols, which encourage them to exchange information about a potential claim early and avoid litigation by agreeing a settlement.

There are obvious benefits to these clauses, which enable the parties to resolve disputes without commencing proceedings. Those benefits include reduced costs and more flexible outcomes,

because a negotiation could lead to a solution that would not be possible in court.

Potentially, they could also enable a continued commercial relationship between the parties – which can be a significant consideration when they have several ongoing or future projects together.

Even if a dispute is not resolved, the issues will often be narrowed and the parties will have a better understanding of each other's positions.

CONTRACT SUITES OFFER STANDARD PROVISIONS

To consider how such clauses work, we can take an overview of the dispute resolution procedures included in standard form contracts.

The following three examples from some of the most commonly used standard forms in the industry are unamended; but parties often tailor these to their specific requirements during the contract negotiation process.

The FIDIC suite, for instance, contains many contracts, but the FIDIC Red Book 2017 has a multi-tiered dispute resolution procedure in clause 21.

The first stage is referral to a DAAB, which is mandatory, and parties cannot commence arbitration unless they have followed this procedure. The second stage is amicable settlement, and the last is International Chamber of Commerce (ICC) arbitration.

This staged process is not intended to comply with the 1996 Act – FIDIC is an international suite of contracts, so the clause would be modified for use on English projects.

The NEC4 Engineering and Construction Contract (ECC) meanwhile allows parties to select the dispute resolution procedure from options W1, W2 and W3. If the contract concerns a project based in England or Wales and the 1996 Act applies, though, then option W2 must be used.

Options W1 and W2 specify referral to senior representatives – although this is discretionary under W2 to comply with the 1996 Act – followed by adjudication. Option W3 on the other hand requires the parties first to refer the potential dispute to a DAB.

The final stage in all options is referral to a tribunal, which entails litigation or arbitration depending on what has been specified in the contract by the parties. Parties cannot take a dispute to the tribunal unless it has first been referred to the adjudicator or board.

NEC4 ECC Practice Note 5 provides an option to use option W3 and the DAB in a way that complies with the 1996 Act, together with adjudication.

Finally, in the JCT 2016 Standard Building Contract (SBC), the dispute provisions in section 9 are less detailed than in FIDIC or NEC4.

The section states that where a dispute cannot be resolved by direct negotiations between the parties – suggesting that this should be the first stage – they should give consideration to mediation, although no method is set out.

Neither of these stages are enforceable, or a condition precedent to further stages in the dispute resolution process.

The SBC provides a contractual right to adjudicate, with the relevant rules being the Scheme for Construction Contracts, therefore reiterating the statutory right to adjudicate for the most part.

Normally, any dispute will be finally resolved by litigation, although the SBC does have arbitration provisions that can be selected pursuant to article 8. RICS is one of the appointing bodies that can be chosen.

It is also worth noting that the JCT DAB Documentation 2021, for use with some other contracts in the suite, has the dual purpose of giving non-binding recommendations and acting as an adjudicator if required, making it compliant with the 1996 Act.

This option is intended to make adjudication a condition precedent to litigation or arbitration.

In addition to the standard forms, there are other recognised dispute resolution procedures that parties can choose to include in their contracts.

One example is the RICS Conflict Avoidance Process (CAP), a contractual mechanism that helps parties avoid prolonged and damaging disputes.

The purpose of CAP is to enable contracting parties to identify and deal with emerging disputes at an early stage.

CASE CONSIDERS ADHERENCE TO RESOLUTION PROCEDURE

Bearing in mind the increasing use of such clauses, it is unsurprising the courts have had to review how they work in practice – and what happens if they are not implemented correctly.

Earlier this year, the Court of Appeal considered the enforceability and effect of a contractual dispute resolution procedure on appeal from a 2022 decision by the Technology and Construction Court (TCC).

The case between Children's Ark Partnerships Ltd and Kajima Construction Europe (UK) Ltd concerned what the court should do where one party had not followed the contractual procedure and commenced court proceedings instead.

There was the added complication that, if the claim were struck out as per the application, a fresh claim would likely be time-barred as the extended limitation period had expired.

In 2004, Children's Ark Partnerships Ltd entered into a project agreement to design, build and finance the redevelopment of a hospital as a private finance initiative. On the same date, it entered into a construction contract with Kajima Construction Europe (UK) Ltd to design, construct and commission the hospital.

The construction contract provided that no claim could be commenced against Kajima after the expiry of 12 years from the actual date of completion of the works. The works began in 2004 with the actual completion date being 2 April 2007.

However, around September 2018, concerns arose around cladding and fire-stopping issues following the Grenfell Tower fire, and Kajima agreed to carry out the remediation works at its own cost on a without-prejudice basis. These commenced in December 2018 but were sequenced over a longer period to minimise disruption at the hospital.

Pursuant to the construction contract the limitation period would have expired on 2 April 2019, before the remediation works were completed. Therefore, a standstill agreement was signed, and subsequently varied, to protect the parties' positions.

The last variation lapsed on 29 December 2021, bringing the extended limitation period to an end, with Kajima having informed the partnerships that it would not extend the agreement on 30 November 2021.

Shortly before the expiry of the limitation period, the partnerships issued proceedings against Kajima, and then applied for a stay of these proceedings to allow the parties to comply with the dispute resolution procedure.

On the same day as the application to stay was made, Kajima applied to strike out the claim on the basis that the partnerships had not complied with the contractual dispute resolution procedure, issuing the proceedings prematurely. The TCC judgment relates to the Kajima application.

The construction contract contained a bespoke multi-tiered dispute resolution procedure. Clause 56 stated that any disputes would be resolved in accordance with the resolution procedure set out in Schedule 26.

In addition, clause 68.2 stated that the courts of England and Wales had exclusive jurisdiction 'subject to the provisions of the dispute resolution procedure'.

Schedule 26 provided for the referral of disputes to a liaison committee and stated that 'all disputes shall first be referred to the liaison committee for resolution'.

However, neither the process to be followed nor a time frame were included in the schedule, and Kajima was not a member of the liaison committee that had been established under the project agreement, with the trust and the partnerships being the only members.

DISPUTE CLAUSE FOUND UNENFORCEABLE

In Children's Ark Partnerships Ltd v Kajima Construction Europe (UK) Ltd & Anor [2022] EWHC 1595 (TCC), the TCC judge dismissed Kajima's application to strike out the claim for the partnerships' failure to comply with the dispute resolution procedure.

The judgment considered a number of authorities about the effect of a contractual agreement obliging parties to refer a dispute to ADR. Key points from the judge's conclusions included the following.

- Complying with the dispute resolution procedure was a condition precedent to the commencement of litigation for the construction contract.
- The dispute resolution procedure was unenforceable: the obligation to refer disputes to the liaison committee was not 'defined with sufficient clarity and certainty', so could not operate as a precondition to the commencement of proceedings.
- If the procedure were enforceable, the judge noted that she would not have exercised her discretion to do anything more than stay the proceedings until the clause was fulfilled; though as she said this in passing, or obiter, it did not therefore create binding authority.

The judge described a stay of the proceedings as a 'default remedy' where claims are commenced prematurely, and compared the situation to that set out in the Pre-Action Protocol for Construction and Engineering Disputes.

If compliance with this protocol may result in a claim being time-barred, then proceedings should be commenced; standard procedure is then for the court to consider a stay, pending compliance.

TCC DECISION BACKED ON APPEAL

In Kajima Construction Europe (UK) Ltd & Anor v Children's Ark Partnership Ltd [2023] EWCA Civ 292, the subsequent appeal was dismissed on all three grounds.

Ground 1 – the enforceability of the dispute resolution procedure: the Court of Appeal held that the TCC had been right to find that the clause was unenforceable for lack of certainty, because it was not clear when the condition precedent might be satisfied.

Grounds 2 and 3 – the exercise of discretion: ground 2 related to the use of a stay being a default remedy, and ground 3 to the TCC judge's alleged failure to have regard to relevant matters, although these grounds were both obiter as the appeal was dismissed on the decision for ground 1.

The court accepted that a stay was not a default remedy in the sense of being automatic or inevitable, but rather it was used as shorthand to describe the usual order that a court would make in the circumstances, based on a review of the authorities.

The court stated that the matters taken into account by the TCC judge were all relevant and that she had been correct to exercise her discretion in favour of a stay, rather than a strike-out; if obliged to re-exercise the court's discretion, the present judges 'would come to the same conclusion'.

Although being deprived of a limitation defence would be a key point of consideration, they said it was not decisive and merely part of the balancing exercise to ensure a proportionate result.

JUDGMENTS EMPHASISE NEED FOR CLARITY

Although this was a bespoke dispute resolution procedure, both decisions provide useful judicial analysis of the appropriate remedy for breach of such clauses.

The cases demonstrate the willingness of the courts to support dispute resolution procedures and enforce commercial agreements between the parties, provided the parties ensure that any obligations are clearly set out and enforceable.

Key points are as follows.

- Courts are willing to enforce dispute resolution procedures.
- Where a party does not comply properly with a clause, the default option for the court is to grant a stay of proceedings to allow compliance, rather than taking the more draconian remedy of striking out the claim.
- It appears that the clause does not need to be a condition precedent for the court to stay the proceedings so that the contractual process can take place. However, it is clear that it might be considered a condition precedent, depending on the drafting of the clause in question.
- A dispute resolution procedure should be followed before commencing proceedings. However, these cases provide comfort that, if a party fails to do so, they are unlikely to have their claim struck out provided they have acted reasonably.
- It is vital that any dispute resolution procedure is drafted clearly to make sure it is enforceable. For example, the people involved, process to be followed, time frame and potential outcome, whether binding or not, should be specified. If the process requires the parties to agree further provisions, it is unlikely to be enforceable.
- Parties should consider using a standard form that has been drafted to include an enforceable dispute resolution process. However, it is not yet known what effect – if any – the decision will have on these clauses.
- In *Kajima*, if the referral to the liaison committee had been clearly drafted and included the elements set out above, it would likely have been an enforceable dispute resolution process. This would have given rise to a condition precedent, with which the parties would have to

comply before commencing proceedings. However, based on the judgment, the court would have done nothing more than stay the proceedings to allow compliance with the process, and the strike-out application would still be dismissed.

Failure to implement a dispute process correctly, although unlikely to be the end of a claim, could lead to a dispute in itself – involving additional time and money for those concerned. Therefore, you should make sure any clauses are clearly drafted and then follow the procedure to the letter.

This article was first published by RICS Construction Journal on 01 November 2023.

RELATED CAPABILITIES

- Construction Disputes
- Commercial Construction & Engineering

MEET THE TEAM



Shy Jackson

London

shy.jackson@bclplaw.com

[+44 \(0\) 20 3400 4998](tel:+442034004998)



James Clarke

London

james.clarke@bclplaw.com

[+44 \(0\) 20 3400 3507](tel:+442034003507)

This material is not comprehensive, is for informational purposes only, and is not legal advice. Your use or receipt of this material does not create an attorney-client relationship between us. If you require legal advice, you should consult an attorney regarding your particular circumstances. The choice of a lawyer is an important decision and should not be based solely upon advertisements. This material may be “Attorney Advertising” under the ethics and professional rules of certain jurisdictions. For advertising purposes, St. Louis, Missouri, is designated BCLP’s principal office and Kathrine Dixon (kathrine.dixon@bclplaw.com) as the responsible attorney.