

# Kluwer Mediation Blog

## Drafting multi-tiered dispute resolution clauses

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There has been a significant increase in the debate on multi-tiered or hybrid dispute resolution clauses, as can be seen in this Blog or the Kluwer Arbitration Blog's debate on multi-tiered clauses or Med-Arb. Those usually comprise various clauses in which the arbitral process is combined with other forms of ADR, either optionally or as mandatory steps. Mediation and arbitration proceedings may also be combined and – to some extent – interconnected. This is often referred to (depending on the order) as Med-Arb, Arb-Med, Med-Arb-Med, Co-Med-Arb and Arb-Med-Arb. In these clauses, sometimes even the same individual or neutral is used in both phases of the process and serves as mediator and arbitrator.

The reason for incorporating a multi-tiered dispute resolution clause is always the same: The parties hope to save time and resources when a dispute arises; Further (often most importantly) they aim to maintain their business relationship. However, such clauses also hold challenges. In the following, we will address practical problems and submit proposals how to approach them. We will focus on clauses in which arbitration is stipulated to be the last resort, requiring the parties to first go through other forms of ADR, as it is the case e.g. in Med-Arb clauses.

### **I. Finding the right dispute resolution mechanism**

First, “fitting the forum to the fuss”, as Frank E.A. Sander and Stephen B. Goldberg put it, should be the guiding principle of drafting any dispute resolution clause. Though dispute resolution clauses usually do not get much attention during the negotiations of contracts, it is worthwhile to briefly brainstorm what kind of disputes may arise. A multi-tiered arbitration clause has the advantage of potentially saving costs if the pre-arbitration steps are successful. However, it may also significantly prolong the proceedings if the steps to be taken before arbitration are not fitting for the specific case.

For example, in construction contracts, time often is of the essence and most potential disputes concern rather technical issues. While the long terms of construction contracts would warrant mediation to preserve the relationship, the mediation process is commonly felt to be too slow. The speedy establishment of the facts, e.g. through a dispute adjudication board or a binding expert assessment, may serve the parties much better than a negotiation or mediation obligation. By

contrast, in long-term service contracts, joint ventures or company articles, solving a dispute on the personal level is often best to avoid, while technical facts play less of a role. Here, mediation or at least negotiation fits perfectly. In some cases, where no relationship is to be preserved (e.g. one time delivery of goods), it may be more efficient to put in a standalone arbitration clause and remind the parties only in a non-binding manner to attempt a settlement.

## **II. Clear language is key**

Once the right dispute resolution mechanism is found, it is paramount to implement it properly. The clause's purpose would be completely undermined if it carries potential for jurisdictional disputes and hence prolongs the proceedings instead of shortening them. If the terms of the pre-arbitration steps are unclear, recalcitrant respondents could raise jurisdictional objections after negotiations were concluded unsuccessfully. A precise wording is particularly important when considering the international nature of the contract: Courts and arbitrators from different jurisdictions may be required to interpret the multi-tiered arbitration clause. While some legal orders restrict the interpretation of the arbitration clause to its written wording, others may allow the parties to argue what their true intent was, especially if the written agreement contains gaps or ambiguities.

To avoid disputes, the clause should also clearly establish whether any pre-arbitration step (e.g. negotiations, mediation) is optional or compulsory before arbitration can be commenced. If the parties want the latter, they need to clearly define the procedures and conditions. In particular, specific time limits help, e.g. by stipulating time-bound mediations that only prohibit parties to initiate the arbitration process during a certain period. Especially for Med-Arb clauses, in which mediation and arbitration are to some extent combined, it is necessary to provide in sufficiently clear terms when the different tiers are triggered, i.e. when the mediation process should start and when arbitration may commence.

Also, the legal effects of multi-tiered arbitration clauses differ substantially from one legal order to another. Some laws treat compliance with the pre-arbitration steps as a procedural condition. Others consider it to be a matter of substantive law. This already entails a myriad of conflict of laws-questions, which cannot be dealt with exhaustively here. However, most legal orders award the parties significant freedom of contract, hence precisely regulating the intended effects can minimize the legal uncertainties.

## **III. Ensuring the practical effectiveness of the clause**

If the parties agree that the pre-arbitration steps are compulsory, the practical effect of multi-tiered arbitration clauses is often disappointing: If a claimant commences arbitration despite the prerequisites not being fulfilled, this usually does not hinder the constitution of the arbitral tribunal. As this process alone consumes time and costs without contributing to the amicable solution of the dispute, much of the purpose of the multi-tiered clause is defeated. Respondents' objections during the arbitration usually only lead to the suspension of the proceedings to allow for negotiation/mediation, as tribunals often see this as more efficient. Unfortunately, with a tribunal already constituted, negotiations are seldomly fruitful.

Would the tribunal apply the applicable laws strictly, this often should not even occur: In some jurisdictions, if the preconditions to invoking an arbitration clause are not fulfilled, any award as to the merits of the disputes would be unenforceable. Other legal orders solve the issue on the

substantive level, which would mean that the premature claims are to be rejected without a possibility to cure it. However, due to the (at times lengthy) process of establishing an arbitral tribunal, arbitrators seem reluctant to simply apply such a rule and prefer suspension of the proceedings. Also domestic courts sometimes avoid to put too much emphasis on pre-arbitration requirements. The parties should explicitly state in the contract that the arbitral tribunal shall reject any claim if the pre-arbitration steps were not undertaken accordingly. Even if the tribunal then finds suspension to be procedurally more efficient, a clear mandate of the parties is unlikely to be ignored.

It would also be conceivable to condition the consent to arbitrate on the compliance with all pre-arbitration steps before the arbitral proceedings are initiated. Then an arbitral tribunal would have little choice but to deny its jurisdiction upon objection of the respondent. This would motivate the claimant to abide by the contract beforehand. Yet, this also bears uncertainties: Some legal orders may not recognize a conditional arbitration clause to be binding. Lacking a binding arbitration clause if the pre-arbitration conditions are not fulfilled, a party may also commence court litigation, an outcome the parties surely did not intend at all.

#### **IV. Challenges of Med-Arb clauses**

Especially when providing for a Med-Arb clause, it should be considered whether the same person should serve as neutral in both proceedings. In some jurisdictions, it is already difficult to find someone who is qualified to act as both, mediator and arbitrator. It should be kept in mind that mediators and arbitrators use different tools and approaches and “not every arbitrator is qualified to be a good mediator and vice versa”.

Additionally, “Switching Hats” in Med-Arb and having the same neutral serving in both proceedings is not permitted in some jurisdictions, since the conflicting roles raise concerns in particular regarding the parties’ perceptions of procedural fairness and confidentiality. Thus, a clear separation of the two processes with different neutrals is recommended. In many jurisdictions, the same neutral as arbitrator and mediator may even create a challenge during enforcement proceedings. Accordingly, we recommend providing for separate neutrals, each responsible for one phase, as this avoids any misuse of confidential information shared in the mediation process. It also motivates the parties to participate wholeheartedly in, and to contribute honestly to the mediation, as they know that this cannot be held against them later in the arbitration.

#### **V. Concluding remarks**

The parties should weigh the potential benefits and concerns of the hybrid modes of ADR carefully. While we consider any form of amicable resolution of the dispute to be preferably to adversary proceedings, implementing a hybrid clause in the contract should not lead to the prolongation of the dispute later. We hope that this contribution assists drafters of a multi-tiered dispute resolution clause to consider which type of ADR mechanism best serves their specific purpose. It is worth noting that the entry into force of the Singapore Mediation Convention will provide a mechanism for enforceability of any mediated settlement agreements even without having them incorporated in an arbitral consent award. However, to date, only 55 states have signed the Convention with merely seven ratification, and it remains to be seen what added value the Convention can bring to the resolution of cross-border disputes.

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