THE ROLE OF MEDIATION IN ARBITRATION:
THE USE AND THE CHALLENGES OF MULTI-TIERED CLAUSES
IN INTERNATIONAL AGREEMENTS

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I. Introduction

A multi-tiered clause is "a clause in a contract which provides for distinct stages, involving separate procedures, for dealing with and seeking to resolve disputes."[2] Some have defined it as a clause that "imposes certain pre-conditions to be fulfilled before arbitration can be initiated by the parties.[3] Besides cost and time concerns, one of the main incentives for using a multi-tiered clause is that it can be designed to provide parties greater flexibility in selecting a more appropriate dispute resolution mechanism. Recognizing that not every dispute between the parties should proceed immediately to arbitration, a multi-tier clause permits a party to utilize a more suitable dispute resolution procedure based on the level or degree of the particular dispute.

The Growth of Mediated Negotiation

The use of multi-tiered clauses[4] in international commercial contracts has been on the rise in recent years.[5] Part of the reason for this increase is the recognition of the growing complexity in contractual relationships, the increase in the number of parties involved and in the varying types of disputes that may occur between contracting parties. The establishment of

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[2] *See* Michael Pryles, *Multi-Tiered Dispute Resolution Clauses*, 18 JOURNAL OF INTERNATIONAL ARBITRATION 159 (2001).

[3] *See* Shaun Lee, *Technology and Outsourcing Hot Spots Series (5) Multi-Tier and Unilateral Arbitration Clauses*, Singapore International Arbitration Blog, January 2013, *available at* http://www.mediate.com/articles/LeeSbl20130125.cfm.

[4] These clauses are also referred to as escalation clauses.

[5] D. Jason File, *United States: Multi-Step Dispute Resolutions Clauses*, Mediation Committee Newsletter, (IBA Legal Practice Division), July 2007, *available at* http://www.wilmerhale.com/uploadedFiles/WilmerHale_Shared_Content/Files/Editorial/Publication/File_Jason_IBAMediation_July07.pdf.

trading blocks, such as NAFTA and MercoSur, which encourage negotiation or mediation prior to arbitration, has also contributed to an increased use of multi-tiered clauses.[6]

A recent survey of Fortune 1000 companies demonstrates that large companies are increasingly relying on other forms of ADR such as mediated negotiation rather than binding arbitration to resolve their disputes.[7] Part of the reason for this preference is related to a general shift to curb costs and risks involved with dispute resolutions.[8] In addition, companies through their general in-house counsel have become more proactive in dealing with disputes in the early stages, rather than waiting for the issues to escalate to a level where only litigation or arbitration can resolve the dispute.[9] It is predicted that mediation and the utilization of multi-tiered clauses will be on the rise because international businesses are seeking not only the most time and cost efficient form of dispute resolution, but also want to exert greater control in resolving the dispute while using proactive methods that allow intervention in the early stages of the dispute.[10]

This article will provide a general overview of the use and application of multi-tiered clauses in international commercial contracts, identifying issues and challenges that might occur in the drafting and enforcement phases.

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[6] *See* Eduardo Palmer & Eliana Lopez, *The Use of Multi-tiered Dispute Resolution Clauses in Latin America: Questions of Enforceability*, 14 AM. REV. INT'L ARB. 285 (2003).
[7] *See* Thomas J. Stipanowich, *What Does the Fortune 1000 Survey on Mediation, Arbitration and Conflict Portend for International Arbitration*, KLUWER ARBITRATION BLOG (Mar. 14, 2013), *available at* http://kluwerarbitrationblog.com/blog/2013/03/14/what-does-the-fortune-1000-survey-on-mediation-arbitration-and-conflict-management-portend-for-international-arbitration/comment-page-1/#comment-428885.
[8] *Id.*
[9] *Id.*
[10] *Id.*

General Benefits of Multi-Tiered Clauses

Multi-tiered clauses are particularly helpful in construction/infrastructure projects[11] and in intellectual property agreements,[12] which are subject to a diversity of disputes, many of which require speedy resolution. Besides offering flexibility in the manner of dispute resolution, another benefit offered by a multi-tiered clause is that it can provide a prompt and cost-effective manner of resolution, otherwise not fully available in litigation and arbitration. Multi-tiered clauses are also used where the parties have a high desire to conserve an ongoing working relationship, utilizing the various ADR techniques as tools to find compromise. Another benefit of using mediation as a stepping stone to arbitration is the increased control parties can exercise over the outcome of the dispute, while fostering creative-problem solving that otherwise would be constrained in a courtroom or arbitration setting. While there are certainly benefits to using multi-tiered clauses, there are also a number of pitfalls, which generally appear at the enforcement stage.

Drafting Multi-Tiered Clauses

Issues generally arise as a result of the manner in which these clauses are drafted. The main issue is generally the lack of specificity in the language used when drafting these types of clauses. If the clause is drafted in such a way that it is unclear whether the negotiation and/or mediation is mandatory or simply optional, parties may undergo extensive ligation to determine whether negotiation or mediation is a pre-condition to the commencement of arbitration proceedings. Additionally, parties are not always mindful in crafting unambiguous wording to define when one tier ends and when the next one commences. The lack of understanding about

[11] *See* Pryles, *supra* note 2.
[12] *See* C. Collar Fernandez & Jerry Spolter, *International Intellectual Property Dispute Resolution: Is Mediation a Sleeping Giant in* AMERICAN ARBITRATION ASSOCIATION, HANDBOOK ON INTERNATIONAL ARBITRATION & ADR 271-288 (2d. ed. 2010).

the characteristics of multi-tiered clauses may undermine the essential benefits of using them, which are cost and time efficiency.

When drafting multi-tiered clauses, parties must be careful in ensuring that the clauses are drafted in a way that meets the parties' particular contractual needs. Multi-tiered clauses can be customized to add flexibility and quick dispute resolution as problems arise in the contractual relationship. Multi-tiered clauses are a prime example of the exercise of party autonomy. Parties have a myriad of options to pursue when drafting these clauses. For example, the clause may only have two tiers: mediation and arbitration; or may include several rounds of negotiations between select personnel, followed by mediation prior to the commencement of arbitration. There is an endless array of ways to structure the multi-tiered clause to fit the particular objectives or needs of the contracting parties.

One of the main problems identified in the drafting of multi-tiered clauses is the use of subjective criteria for determining when one tier has ended and when the next tier of dispute resolution should commence.[13] For example, a party may include a clause that uses vague or subjective language such as the following: "*in the event of a dispute, parties shall utilize best efforts to attempt to negotiate a solution that it satisfactory to both parties prior to the commencement of arbitration proceedings."* Without a time limitation on the negotiation stage, how does a court or tribunal determine whether the parties should have more time to negotiate or whether one meeting of the parties without resolution suffices to permit a party to commence arbitration? How does the court determine whether the parties have used "best efforts"? In the international setting, the scenario tends to bring more challenges since the parties may seek shelter from courts in different jurisdictions either at the outset of the case or during the enforcement stage.

[13] *See* Palmer, *supra* note 6.

Courts have generally found multi-tiered clauses unenforceable where the language in the clause is too uncertain. For example, where the clause does not contain an unequivocal agreement to enter into mediation or clear procedures governing how the mediation will take place, the court may decline to enforce it.[14] In *SulAmerica CIA Nacional de Seguros S.A. v. Enesa Engenharia, S.A.*, the England and Wales Court of Appeal reaffirmed the Court of First Instance, finding that the mediation clause was not a condition precedent to arbitration because it "contained no unequivocal undertaking to enter into mediation, no clear provisions for the appointment of a mediator and no clearly defined mediation process."[15] In other words, essential issues regarding the mediation process had yet to be agreed upon by the parties, thereby not giving rise to a legal obligation to mediate as a precondition to arbitration.[16]

The IBA Guidelines on Drafting International Arbitration Clauses provide some general guidance to parties on drafting multi-tiered clauses.[17] These IBA Guidelines include specific recommendations in addition to sample language to use when drafting multi-tiered clauses.[18] Among the recommendations, the IBA Guidelines suggest the following: (1) parties should specify a period of time for negotiation or mediation, which should begin upon the occurrence of a specific event (i.e. written request by a party to negotiate); (2) parties should use language that unequivocally makes negotiation and/or mediation mandatory (i.e. using the words "shall" instead of "may"); (3) parties should specify which disputes are subject to mediation/negotiation (i.e. counterclaims are subject to the mediation/negotiation requirement).[19]

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[14] *SulAmerica CIA Nacional de Seguros S.A. v. Enesa Engenharia, S.A.*, Case No. A3/2012/0249, Mar. 20 2012, EWCA Civ 638.
[15] *Id.*
[16] *Id.*
[17] *See* IBA Guidelines for Drafting International Arbitration Clauses, INTERNATIONAL BAR ASSOCIATION, adopted by a resolution of the IBA Council on Oct. 7, 2010.
[18] *Id.*
[19] *Id.*

However, sometimes parties will realize that negotiations and/or mediation will fail to yield any sort of resolution to a dispute. In these cases, if the contract contains an escalation clause, parties may be forced to go through the steps of negotiating and/or going to mediation in order to have the ability to commence arbitration despite the fact that it is evident that such course of action will be futile.

The Condition Precedent Pitfall

Courts have interpreted multi-tiered clauses to set up certain conditions precedent that must occur before parties can submit the dispute to arbitration. Whether or not a court will find an agreement to negotiate or mediate prior to arbitration all depends on the construction of the particular clause and interpretation given by a specific jurisdiction. If the clause is drafted with clear, precise, unequivocal language, courts are more likely to find the pre-arbitration procedures mandatory to the institution of arbitration. To ensure the enforcement of a multi-tiered clause, parties can expressly condition the commencement of litigation or arbitration on having first complied with other forms of dispute resolution, such as mediation. For example, U.S. courts have generally found that a well-crafted multi-tiered clause creates a condition precedent prior to activating the arbitration clause. In other words, U.S. courts have declined to compel arbitration when the parties have failed to meet the condition precedent, which in most cases is a requirement to mediate.[20]

There may be instances where circumstances are such that it is evident that negotiations or mediations efforts will be futile. In these cases, one of the parties may wish to accelerate to the arbitration phase under the clause in order to save time and costs. However, depending on

[20] *See e.g. Kemiron Atl., Inc. v. Aguakem Int'l Inc.* 290 F.3d. 1287, 1291 (11th Cir. 2002) (finding that the parties had intended arbitration "to be a dispute resolution mechanism of last resort, " finding that since neither party had "requested mediation, the arbitration provision had not been activated and the FAA does not apply"); *HIM Portland, LLC v. DeVito Builders, Inc.*, 317 F.3d 41 (1st Cir. 2001) (court declining to compel arbitration, as condition precedent in the form of mediation had not yet occurred).

how the clause is drafted the party may find itself having to fulfill the condition precedent before a court will compel the other party to arbitration.

Solutions to the Condition Precedent Issue

Scholar Gary Born has remarked that the breach of a negotiation clause should not prevent the parties from proceeding to arbitration, and that such breach should be considered as a procedural requirement to the arbitration process, rather than a condition precedent.[21] Otherwise, parties could purposefully avoid negotiation or mediations stages to either avoid arbitration all together or to utilize it as a delay tactic.

In fact commencement of arbitration proceedings could incentivize parties to reach a settlement in the dispute.[22] If it is simply a procedural step to arbitration, than a tribunal would have jurisdiction to determine whether a party satisfied the negotiation or mediation stage. A party in that case would have difficulty in vacating the arbitral award based on a breach of the negotiation or mediation clause. On the other hand, if the parties have expressly agreed to negotiation or mediation as a condition precedent, than the tribunal would lack jurisdiction potentially invalidating any arbitral award issued due to the breach of the multi-tiered clause.

In an attempt to promote mediation, some institutions, such as the ICDR, have introduced standard clause language that allows parties, who are concerned with having a pre-condition to arbitration, to concurrently seek arbitration with mediation. In other words, the ICDR Concurrent Arbitration and Mediation Standard clause "provides for mediation to start automatically after the demand for arbitration is filed."[23] These types of clauses serve to alleviate any misgivings

[21] *See* GARY B. BORN, INTERNATIONAL COMMERCIAL ARBITRATION, 241 (3d. ed. 2009).
[22] *See* Loukas Mistelis, *The Settlement-Enforcement Dynamic in International Arbitration,* 19 AM. REV. INT'L ARB 377, 382-83 (2009) ("There seems to be agreement that the commencement of the arbitration is the key settlement driver. There are, of course, variations amongst corporate counsel: some claim that the threat of the commencement of arbitration compels the parties to explore settlement seriously; others argue that the prospect of paying some serious fees for lawyers and arbitrators pushes the parties into settlement action").
[23] Steven K. Andersen, *ICDR Offers Concurrent Mediation /Arbitration Clause,*63 DISP. RESOL. J. 15 (2009)

that parties may have about utilizing a multi-tiered clause in the event that a party wishes to move straight to arbitration without delay.

Enforcement Issues

Another major issue identified with the use of multi-tiered clauses is whether all stages of the dispute resolution procedure are enforceable.[24] For example, some have recognized that stages of negotiation and mediation, due to their consensual nature, may not be enforceable.[25] A party cannot compel another party to negotiate or participate in mediation.[26] For example, English Courts have held that an agreement to negotiate is not enforceable.[27] In Colombia, an arbitration tribunal failed to enforce a multi-tiered clause on the basis that a party's constitutional right to access the administration of justice cannot be limited by the parties' agreement.[28] In that case, the parties had included a multi-tiered clause which provided for a conciliation phase followed by negotiations directly between the presidents of the parties.[29] When the party objected to the tribunal's jurisdiction based on the refusal of the other party to adhere to the conciliation and negotiation phases, the tribunal contravened party autonomy to find that it had jurisdiction despite the multi-tiered clause.[30]

In the United States, courts do not necessarily agree on the enforceability of the parties' agreement to negotiate prior to arbitration.[31] This is partly due to the fact that it is difficult to have guidelines by which to determine whether a party abided by its contractual duty to utilize its

[24] *See* Pryles, *supra* note 2.
[25] *Id.*
[26] *Id.*
[27] *See* Paul Smith Ltd. V. H& S International Holding Inc., [1991] 2 Lloyd's Rep 127.
[28] *See* ICC Tribunal, November 17, 2004 (Bogota, Colombia), *available at* kluwerarbitration.com.
[29] *Id.*
[30] *Id.*
[31] *See* File, *supra* note 5.

best efforts in negotiations.[32] Generally the more specific the clause is, the more likely it will be enforced. For example, U.S. courts have looked at the following factors in determining whether the pre-arbitration phase is enforceable: (1) definiteness of the clause, (2) whether the parties agreed to a specific time-frame for negotiations, and (3) whether the parties specified the participants from each party or designated the rules that would govern mediation.[33] While this is not an exhaustive list, it illustrates the kind of elements that parties should consider including.

In contrast, once the parties have agreed to include an arbitration clause, a court can compel a party to participate in arbitration proceedings. Arguably, depending on the language used in the clause, a court could however find an enforceable contractual obligation by each party to participate in negotiations or mediation prior to arbitration. A party therefore may be compelled to participate in mediation or negotiation prior to commencing arbitration. While a party can be compelled to participate, it cannot be compelled to resolve the dispute at the mediation or negotiation phase if the party is determined to go to arbitration. When a party is unwilling to compromise or negotiate, there is a risk that the initial steps of negotiation or mediation end up as simply formalities that further delay the resolution of the dispute.

Specificity is the Name of the Game

If parties want to ensure enforceability of their multi-tiered clauses, they most include specific and mandatory language. Recently, the Swiss Supreme Court dealt with a case that had a multi-tier dispute resolution clause. In that clause, the parties had agreed to conciliation prior to arbitration.[34] However, because the multi-tiered clause between the parties lacked specificity, the Tribunal found that one meeting between the parties, even though informal, was sufficient to

[32] *See e.g. Candid Prod. Inc. v. Int'l Skating Union*, 530 F. Supp 1330 (S.D.N.Y. 1982 (finding that the agreement to negotiate in good faith was too vague and indefinite to be enforceable).
[33] *See* File, *supra* note 5.
[34] Swiss Supreme Court, Decision 4A_46/2011, May 16, 2011, *X GmbH v Y Sàrl*.

satisfy an attempt at conciliation.[35] Additionally, the tribunal found that since the circumstances of the dispute indicated that no conciliation between the parties would be possible, arbitration was the only solution and therefore it was futile to enforce the conciliation phase. The Swiss Supreme Court agreed with the Tribunal's finding that the clause, which lacked any time limitation on the pre-arbitration procedure, was not specific enough for it to be mandatory requirement prior to arbitration.[36]

In a recent case in Singapore, the High Court overturned the lower court's decision against enforcing a multi-tiered clause requiring the parties to negotiate and mediate prior to arbitration.[37] The court found that the multi-tiered clause laid out specific requirements which were enforceable as a condition precedent to arbitration.[38] In Brazil there is no case-law that falls squarely on the enforceability of multi-tiered clauses. The reason may come out from the lack of knowledge of the characteristics of such clauses or simply because parties settled during the initial stages of the dispute. Due to the increase of infrastructure work in the country however, conflicts involving the enforceability of multi-tiered clauses will likely to be on the rise.

Decisions on the enforceability of multi-tiered clauses in either civil or common law jurisdictions demonstrate that if parties want to enforce a multi-tiered clause they must include mandatory and specific language. Parties should specify the procedures and time frames for each negotiation or mediation phase in order to provide definite criteria for the enforcement of these phases prior to arbitration.

[35] *Id.*
[36] *See id.*
[37] *See International Research Corp PLC v Lufthansa Systems Asia Pacific Pte Ltd [2012] SGHC 226.*
[38] *Id.*

Concluding Remarks

While multi-tiered clauses are usually considered to provide a cost-effective and relatively speedy resolution of disputes, parties should seriously be *en garde* as to how these clauses are drafted and learn about the applicable or potential jurisdiction's views on enforcing multi-tiered clauses. The growth and complexity of international commerce will have parties constantly seeking speedier and more cost-effective mechanisms for resolving their disputes. Multi-tiered clauses, while certainly not without their pitfalls, provide a platform for parties to have greater flexibility and enhanced control over the management of disputes. Besides added freedom and flexibility, multi-tiered clauses – if their characteristics are properly understood and their wording well drafted – may be a relevant tool for the parties, who want to preserve ongoing relationships in international agreements.