

DRAFTING THE DISPUTE RESOLUTION CLAUSE: *The Midnight Clause*

BY

'Funmi Roberts

Introduction

Parties to a contract and their team of lawyers may have spent many man-hours negotiating the terms of the contract, guided principally by powerful economic incentives. At the close of negotiations, when the negotiating teams are tired and bedraggled, counsel to one of the parties suddenly remembers the need to insert a dispute resolution clause in the contract. If care is not taken, the agreement would end up with an ineptly drafted dispute resolution clause.

The phrase "*the Midnight Clause*"¹ came into being because the clause is often the last clause negotiated by the parties after all other clauses have been concluded. Yet, the most important clause in any contract is the dispute resolution clause for so many reasons, not the least of which is that the way contracting parties manage any dispute, disagreement or controversy that arises in the course of implementing the contractual agreement, would invariably determine their future commercial relationship.

Enforceability of Dispute Resolution Clauses

In commercial transactions, dispute resolution clauses are drafted mainly in 3 circumstances:

- (i) During pre-contract negotiations;²

- (ii) Post-contract but ***before*** a dispute arises; or

¹ *Alan Redfern & Martin Hunter. Law and Practice of International Commercial Arbitration, 3rd ed. Pg 136.*

² This is preferred as the parties are at this stage still communicating in an atmosphere of cooperation;

- (iii) Post-contract but *after* a dispute arises.

Until recently, there was some uncertainty in the United Kingdom about the legal effect of contractual ADR Clauses. In *Cable & Wireless Plc. vs. IBM United Kingdom Limited*,³ the dispute resolution clause read partly that 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).

While holding that the clause is enforceable, Colman J. stated the rationale as follows:

...the parties have not simply agreed to attempt in good faith to negotiate a settlement.....they have gone further than that by identifying a particular procedure.....that is one of the best known and most experienced dispute resolution providers in this country.

Other countries in Europe appear to have followed this trend.⁴ In Australia, courts are vested with wide discretion to order mediation. In the United States of America, ADR is as much a part of the judicial system as arbitration and litigation does.

Guide to Drafting a Dispute Resolution Clause

The following are apt considerations to be made while drafting a dispute resolution clause:

³ (2002) 2 All E.R. 1041

⁴ For example, in February 2003, the Cour de Cassation (French Supreme Court) had in one case ordered stay of proceedings for parties to explore the contractual mandatory ADR process.

- (i) ***Understand the deal/transaction:*** It is important to draft a dispute resolution clause to suit the particular transaction for which it is intended. No one transaction is the same. The draftsman must therefore recognise the uniqueness of each deal or transaction to determine the dispute resolution mechanism. The wrong dispute resolution mechanism may have an adverse effect and thereby defeat the purpose of the dispute resolution clause. The Claimant one arbitration got frustrated because it could not afford the attendant costs of arbitration when the dispute did arise. The arbitration agreement in the contract that was for the sum of N2 million, had provided for the determination by three arbitrators. If there was one agreement not suited to a 3-man tribunal, this was it.
- (ii) ***Know and understand the parties:*** A draftsman should always be guided by the profile of the parties and their background. The importance of this is underscored in the example of a corporation created by statute. The enabling statute of a corporation may contain a section which provides that suits brought against that Corporation must be commenced within a certain period of time after the dispute arises.⁵ The law is now settled that negotiations between disputants do not affect any statutory time bar. Accordingly, a draftsman must such considerations to place him in good stead in choosing a dispute resolution clause that admits of determination of the dispute in a timely manner so as not to be caught by any statutory bar. Beyond this, it is not out of place to review past commercial relationship between the parties, if any.
- (iii) ***Conduct reality tests with the parties:*** It is important to get the parties involved in drafting their dispute resolution clause, after all it is their deal and the clause is as much a part of it as the other terms in the body of

⁵ For example, s. 12 of the NNPC Act provides that actions against the corporation must be brought within 12 months after the act complained of.

the contract. It is the parties that would have to defend their respective positions when a dispute arises. Therefore, they will more likely be readily disposed to abide by the terms of the dispute resolution clause that they actively participated in negotiating.

- (iv) **Authority to settle:** The dispute resolution process is only as good as the authority of the parties' representatives to bind their parties. The dispute resolution clause must specify the officials of the parties that will represent them during the dispute resolution process in contemplation. Otherwise the whole exercise may turn out to be futile, where at that stage the representative in attendance lacks the authority to compromise or take crucial decision regarding the dispute. If a higher authority is considered necessary to confirm an agreement reached, express provision should be made for this approval to be rapidly obtained.

- (v) **Avoid the "7 sins":** These 'sins'⁶ although written in relation to arbitration clauses, hold true for other dispute resolution techniques too:
 - (a) **Equivocation:** First identified by Lawrence Craig, Rusty Park & Jan Paulson,⁷ this deals with the failure of the clause to state clearly that the parties have agreed to binding arbitration/ADR. The draftsman must unequivocally distil into the agreement, the intention of the parties to resolve any dispute that may arise between them by an ADR mechanism and be bound by the decision reached in consequence, otherwise the courts would readily declare such clauses unenforceable for uncertainty.

⁶ John M. Townsend, "Drafting Arbitration Clauses: Avoiding the Seven Deadly Sins" *Dispute Resolution Journal* February –April 2003 (Volume 58 No. 1) pg 1.

⁷ International Chamber of Commerce Arbitration, 2nd ed. Oceana Publications cited by John M. Townsend *supra*.

- (b) *Inattention*: Insufficient attention to the circumstances of the transaction as well as the needs of the parties. Boilerplate clauses should only be used if it is appropriate for the deal.
- (c) *Omission*: A draftsman that omits a crucial or useful element commits the sin of omission. This can result in an agreement to arbitrate, but it may fail to provide guidance as to how or where to do so.
- (d) *Over-specificity*: The opposite of the sin of omission is the sin of "Over-specificity", that is, providing too much detail in consequence of which the clause may become difficult, if not impracticable. For example:

"The Arbitration shall be conducted by 3 arbitrators each of whom shall be fluent in Hungarian and shall have 20 or more years of experience in the design of buggy whips, and one of who shall act as chairman, shall be an expert on the law of the Haps burg Empire"

- (e) *Unrealistic expectations*: The companion sin to over-specificity. This usually occurs when a dispute resolution clause is deadline-driven. This also underscores the need to conduct reality-tests with the parties. Long, wordy and complex clauses, that attempt to provide for all details and eventualities should be eschewed whilst succinctness should be embraced.
- (f) *Litigation-envy*: Some lawyers still cannot be reconciled to the thought of letting go of the familiar security blanket of litigation. An example of what often emanates from this is a clause that

calls for the arbitration to be conducted according to the rules of court.

- (g) *Overreaching*: This happens when the draftsman cannot resist the urge to tilt the dispute resolution process in favour of his client. Townsend concluded that this is not only wrong, but it can also be counter-productive.

In all, it is most important for a dispute resolution clause to be centred on its objective, bearing in mind the peculiarities of the parties.

Multi-Tier Dispute Resolution Clause

The Multi-Tiered Dispute Resolution Clause provides for a graduating process, in that it is a clause that moves from the party-controlled and party-determined mechanism to one which gives a third party the power to impose a final decision on the disputants. It provides parties with the benefit of different forms of dispute resolution. Although it culminates with arbitration, the pre-arbitration processes are conditions-precedent to arbitration. It is also a time or deadline-driven clause.

- (i) ***First Tier – Negotiation***: At this stage parties are required to negotiate and attempt to resolve the dispute between them. A challenge here is that it is often difficult for disputants to have the right people seat together for any meaningful discussion. A way around this is to specify in the clause the officials of the parties who shall attend the negotiations and who shall have authority to settle. The time within which the negotiation must be held should also be stated therein. The following is a sample clause:

If any dispute, difference or controversy arises out of or in relation or connection to this Agreement, including any dispute, difference or controversy about its performance,

construction or interpretation, ('the dispute') the parties shall in the first instance attempt in good faith to resolve it promptly by discussions and negotiation between Senior Executives who have authority to settle the dispute or difference or controversy. Either party shall give the other party written Notice of the dispute and within fifteen (15) days after delivery of the Notice, the receiving party shall submit to the other a written response. The Notice and response shall include: (i) a statement of that party's position and a summary of the arguments supporting that position, and (ii) the name and title of the Executive that will represent that party and any other person that will accompany the Senior Executive. Within thirty (30) days after delivery of the initial notice, the Senior Executives of both parties so determined shall meet at a mutually acceptable time and place, and thereafter as often as they reasonably deem necessary, to attempt to resolve the dispute, difference or controversy.

All negotiations made pursuant to this clause are confidential and shall be treated as such by the parties.

The clause may however also specify the venue for the negotiation meetings.

- (ii) ***Second Tier - Mediation:***⁸ The same considerations that apply to negotiation also apply to mediation. The clause should state how the Mediator is to be appointed with provision for a default appointment procedure in the event that the parties are unable to agree on the Mediator. Care must be taken to ensure that the name of an appointing institution/authority is correctly stated, and that the

⁸ There are other ADR mechanisms besides mediation that are not covered in this paper. Parties should be well advised as to the suitability of the particular ADR mechanisms.

reference would be such that is undertaken by that institution. The following is a sample clause:

If the dispute, difference or controversy has not been resolved by negotiation as provided herein within 60 days after delivery of the initial notice of negotiation, or such extended period as the parties may agree, the parties, shall endeavour to settle the dispute by mediation under the Mediation Procedure and Rules of(the Lagos MultiDoor Courthouse). Unless otherwise agreed, the parties will select a mediator from the Panel of Neutrals of the (Lagos MultiDoor Courthouse). The parties shall be represented at the mediation by senior executives who shall have authority to settle.

Any costs incurred for the negotiation and mediation shall be borne equally by the parties.

If institutional mediation is not to be incorporated in the clause, then is apt for the clause to provide for a number of other issues including confidentiality, default appointment procedure, venue for mediation, and status of parties' representatives at the mediation.

(iii) ***Third Tier - Arbitration:*** The arbitration clause is perceived as the most technical aspect of the dispute resolution clause. However, if the under-listed points are borne in mind, there is no reason why a competent draftsman cannot come up with a detailed enforceable arbitration clause. In addition, the interplay of the following must be thoroughly examined and borne in mind whilst drafting an arbitration agreement:

(a) Law governing the capacity of the parties to enter into an arbitration agreement;

- (b) Law governing the arbitration agreement;
- (c) Law governing the arbitration, that is, its proceedings;
- (d) Substantive law of the contract;
- (e) Conflict of laws, if applicable;
- (f) Law governing the recognition and enforcement of the Award.

Other matters that ought to be considered include number and qualification(s) of the arbitrators, seat of the arbitration, law governing the arbitration, rules governing the arbitration, venue/place for hearing (where different from the seat of the arbitration), language of the arbitration, and possible impact of any International Treaty or other International Law on the arbitration. The following is a sample clause:

In the event the parties are unable to settle the dispute difference or controversy by mediation within 30 days of the appointment of the mediator as herein provided, it shall be referred to arbitration in accordance with the provisions of the Arbitration and Conciliation Act Cap. A10, Laws of the Federal Republic of Nigeria 2004. The arbitration shall be conducted by a sole arbitrator to be mutually agreed upon by the parties and failing such appointment to be appointed by the Chairman, Chartered Institute of Arbitrators, (UK), Nigeria Branch. The place of the arbitration shall be Lagos, Nigeria and the language of the arbitration shall be English. The decision of the arbitrator shall be final and binding on the parties.

A multi-tier arbitration clause could be drafted like the *Scot vs. Avery*⁹ arbitration clause, the essence of which clause is to prevent recourse to arbitration or litigation until the non-contentious process has been undertaken and failed to result in an agreement, and the following precedent may be used for stand-alone arbitration clauses.

⁹ (1856) 10 All E.R. 1121

Conclusion

Disputes are commonplace in commercial transactions and contracting parties are developing a stronger leaning towards resolution of disputes through more consensual and commercially expedient means. These however must be guided by well thought-out dispute resolution clauses included in their contracts. To meet the aspirations of parties therefore, it is important for a draftsman to pay close attention to matters that aid the drafting of a clause that creates an effective and efficient dispute resolution process for the parties, whether the process is multi-tiered or otherwise.