



alternative dispute resolution update

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Dispute resolution clauses - are they valid and is a requirement to negotiate in good faith enforceable by the Courts?

It is now becoming increasingly common for parties to a commercial contract to take preventative steps to avoid litigation by the use of a suitably worded dispute resolution clause. Surprisingly, despite the parties' best intentions, such clauses are quite frequently not enforceable by the Courts due to poor drafting. The main criticism of the Courts in relation to such clauses is that they amount to an "agreement to agree" and are too vague, preventing a clear interpretation.

Current legal position

The current legal position in relation to dispute resolution clauses is as follows:

- where a dispute resolution clause in a contract provides some formula or machinery for a dispute to be determined, not being dependant on further agreement between the parties, the clause will be valid and enforceable;
- the law does not recognise as an enforceable contract, clauses that amount to an "agreement to agree" or a requirement for the parties to negotiate a contract in the future. This is because they lack certainty and are too vague; and
- where the dispute resolution clause requires the parties to "negotiate in good faith", it may be binding if the parties have also agreed on the criteria or objective yardstick against which the negotiations may be judged, objectively, in the event of a dispute. Where no such criteria or objective yardstick exists, this type of clause will be found to be invalid and unenforceable.

Invalid clause

An example of a dispute resolution clause found to

be invalid and unenforceable by a Court is set out below:

"If a dispute or difference is referred to the relevant person, then the Representatives... must within 5 Business Days of the date on which the notice...is received...:

- i. meet and undertake genuine and good faith negotiations with a view to resolving the dispute or difference:
- ii. if they cannot resolve the dispute or difference, endeavour to agree upon a procedure to resolve the dispute or difference."

In this case, the Court held that clause (i) was uncertain and unenforceable and that clause (ii) was clearly an "agreement to agree" with there being no yardstick of good faith and therefore it was also unenforceable.

A further example of an invalid clause arose in a case in which a Court held that a mediation agreement which provided that, "Each party confirms that it enters into this mediation with a commitment to attempt in good faith to negotiate towards achieving a settlement of the dispute" was not sufficiently certain to be given effect.

Valid clause

An example of a dispute resolution clause found to be valid and enforceable by a Court is set out below:

"In the event of a dispute between the parties as to the proposed terms of the Sale Agreement....either party shall be entitled to

cause Senior Counsel of not less than 5 years standing (who shall act as an expert and not as an arbitrator) to receive instructions to determine the terms of the Sale Agreement which shall bind the parties. In the event that the Senior Counsel nominated is not acceptable to the other party then Senior Counsel shall be a person nominated by the President of the New South Wales Bar Association.”

In this case, the Court found that there was no defect in the means of arriving at the terms of the sales agreement.

Tips for effective drafting

For a dispute resolution clause to be valid and

enforceable, parties to the contract should ensure that such a clause satisfies the following requirements:

- the clause contains some formula or machinery for the dispute to be determined which is not dependant on further agreement between the parties; and
- where there is a requirement to “negotiate in good faith”, the clause contains some criteria or objective yardstick against which the negotiations may be judged, objectively, in the event of a dispute.

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