A Condition Precedent of 'Friendly Discussion' Before Arbitration is Enforceable

The English Commercial Court has upheld a dispute resolution clause which required the parties to attempt to resolve the dispute by "friendly discussion" before arbitrating.

In *Emirates Trading Agency v Prime Mineral Exports Limited*,[1] the English Commercial Court upheld a contractual term which required parties to first seek to resolve their dispute by 'friendly discussion' before starting arbitration. This is a departure from the position that agreements to negotiate, or to settle disputes amicably, are too uncertain to enforce.

The Fact

The claimant ('Emirates') agreed to purchase iron ore from the defendant ('PME') under a long-term contract which contained the following provision:

> 11. Dispute Resolution and Arbitration
>
> 11.1 In case of any dispute or claim arising out of or in connection with or under this LTC (...) the Parties shall first seek to resolve the dispute or claim by friendly discussion. Any party may notify the other Party of its desire to enter into consultation to resolve a dispute or claim. If no solution can be arrived at in between the Parties for a continuous period of 4 (four) weeks then the non-defaulting party can invoke the arbitration clause and refer the disputes to arbitration.
>
> 11.2 All disputes arising out of or in connection with this LTC shall be finally resolved by arbitration in accordance with the Rules of Arbitration of the International Chamber of Commerce ("ICC"). The place of arbitration shall be in London ("UK"). The arbitration shall be conducted in the English language.

In the first shipment year, Emirates failed to lift all of the ore expected to be taken up and so PME sought liquidated damages. During the next shipment year, Emirates failed to lift any iron ore at all and so PME served a notice of termination of the contract and claimed liquidated damages. PME stated that it reserved its right to arbitrate in accordance with clause 11, without giving further notice, if the damages claimed were not paid within 14 days.

Several meetings took place between Emirates and PME during which Emirates asked for more time to pay the liquidated damages claim (and to find buyers for the unlifted ore). Six weeks after service of PME's notice, Emirates formally responded denying that PME was entitled to terminate the contract and referring to the 'ongoing settlement talks'. The meetings between the parties continued and settlement options were discussed. Ultimately the parties failed to reach a settlement and PME referred the dispute to arbitration in London, under the ICC rules, in accordance with clause 11.2.

Emirates challenged the jurisdiction of the arbitral tribunal, arguing that under clause 11.1 of the contract, it was a condition precedent to the tribunal's jurisdiction that the parties engage in 'friendly discussion', and that this condition had not been complied with. The arbitrators dismissed the jurisdictional challenge, holding that: (1) clause 11.1 did not contain an enforceable obligation; and (2) in any event, friendly discussion had taken place and so the alleged pre-condition (if enforceable) was satisfied.

Emirates then made an application to the English court, under section 67 of the Arbitration Act 1996, seeking an order that the arbitral tribunal lacked jurisdiction to hear the claim. Emirates again argued that clause 11.1 was a condition precedent to the tribunal's jurisdiction. It also argued that the clause required there to be a 'continuous period of 4 (four) weeks' of negotiations to resolve the claims, and that negotiations had not lasted 4 (four) weeks. PME argued that the relevant provision was merely an agreement to negotiate, and was therefore too uncertain to be enforceable; and that in any event, if clause 11.1 was enforceable, the condition had been complied with.

Enforceability of an Obligation to Enter Into 'Friendly Discussion'

Teare J reviewed the relevant authorities in this area.

In *Walford v Miles*[2] the House of Lords had ruled that a bare promise to negotiate was too uncertain to be enforceable as a contractual term. That question had arisen in the context of the owner of a business promising to end negotiations to sell the business to a third party, in exchange for the claimant promising to continue negotiations to buy the business.

Later cases had explored the enforceability of agreements to settle disputes by alternative dispute resolution ('ADR').

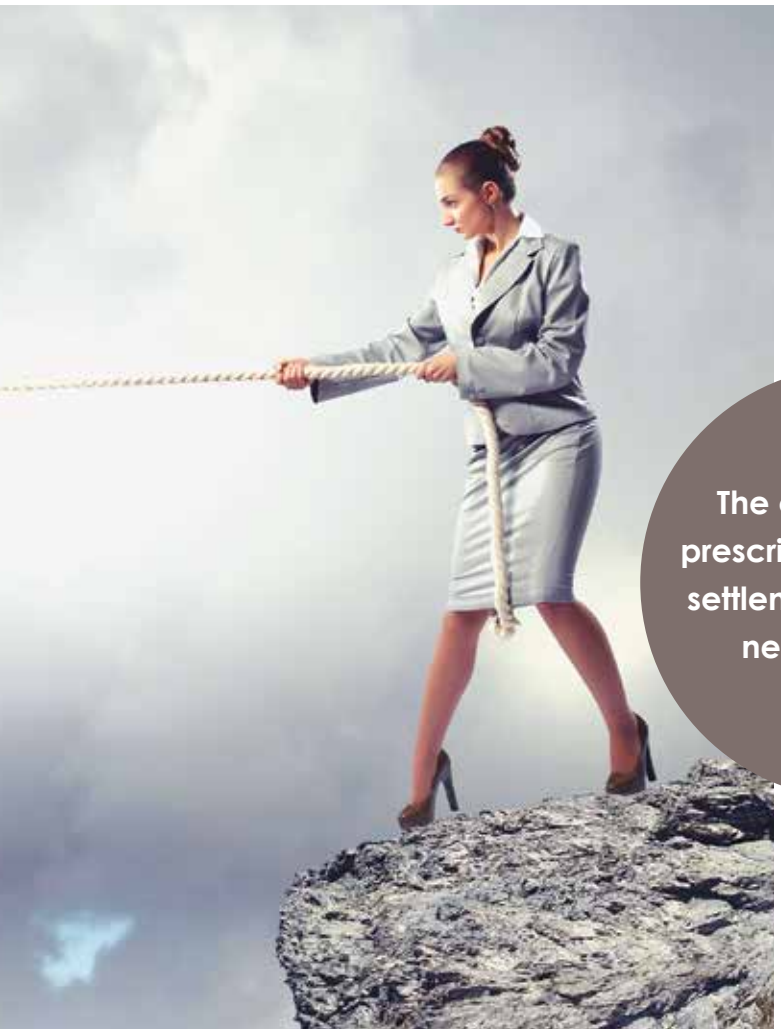
In *Cable & Wireless v IBM*,[3] Colman J had held that an obligation to attempt, in good faith, to settle a dispute through ADR was sufficiently certain to be enforced. The reason was that there was a specified procedure to be followed, namely one laid down by the Centre for Effective Dispute Resolution ('CEDR'). If it had not been clear what procedure should be followed, then the provision would have been unenforceable for lack of certainty.

Similarly, in *Sul America v Enesa Engenharis*,[4] the English Court of Appeal had held that an agreement to seek to resolve a dispute amicably by mediation did not create an enforceable obligation to start, or participate in, a mediation process unless the agreement set out the mediation process or referred to the services of a specific mediation provider.

In *Wah v Grant Thornton*,[5] Hildyard J had held that 'agreements to agree and agreements to negotiate in good faith, without more, must be taken to be

unenforceable: good faith is too open ended a concept or criterion to provide a sufficient definition of what such an agreement must as a minimum involve and when it can objectively be determined to be properly concluded.' However, Hildyard J had gone on to state that ADR clauses could be enforced in certain circumstances – in his decision, the test was not whether a clause was a valid provision for a recognised process of ADR, but whether the condition which the clause imposed was sufficiently clear and certain to be given legal effect.

Teare J noted that these authorities might be understood as having the effect that any obligation to enter into friendly discussion, as a pre-condition to arbitrating, was unenforceable. However, in his opinion, *Walford v Miles*[6] was to be distinguished on the basis that it did not relate to a dispute-resolution agreement. He noted that *Walford v Miles* had already been distinguished in other cases (which did not involve dispute resolution clauses), and also took comfort from recent developments in Australia and Singapore, and decisions of ICSID tribunals, which had upheld contractual obligations to engage in pre-arbitration negotiations.



Teare J concluded that the condition precedent in clause 11.1 was contractually binding, and should be enforced, for the following reasons:

1. The agreement was not incomplete in the sense that any essential term was lacking.

2. The obligation was not uncertain. An obligation to seek to resolve a dispute by friendly discussion imported a duty to act in good faith, and had an identifiable standard, namely fair, honest and genuine discussions aimed at resolving a dispute. The judge acknowledged that there might be difficulty proving whether, in fact, a breach had occurred but that should not be confused with the question of whether, analytically, the scope of the obligation was uncertain.

3. It was in the public interest to uphold such agreements when they are found as part of a dispute resolution clause. Commercial people expect the courts to enforce obligations which they have freely undertaken. Furthermore, the judge emphasised that there was a clear public policy in enforcing an agreement, the objective of which was to avoid expensive and time-consuming arbitration.

Scope of the Obligation Contained in Clause 11.1

The judge rejected Emirates' argument that clause 11.1 envisaged settlement negotiations lasting for a minimum of four continuous weeks. Instead, he found the clause to mean that arbitration could be invoked if the parties had had any friendly discussion, and a solution had still not been found after a continuous period of four weeks had elapsed: the clause did not prescribe how long the settlement discussions needed to last. Therefore, although compliance with the clause was a binding condition precedent to arbitration (and thus to the tribunal having jurisdiction), the parties had complied with it and the arbitration had been properly commenced.

The clause did not prescribe how long the settlement discussions needed to last.

Implications of This Judgment

The judge's conclusion that a clause requiring 'friendly discussion' was an enforceable condition precedent to arbitration is a notable change in the English courts' approach. The judge's decision has much to commend it, but it is foreseeable that the judgment will be used by recalcitrant parties to try to avoid or delay their being held to account.

When a dispute arises, it is now important for the prospective claimant to comply strictly with any provision in the contract which is arguably a pre-condition to starting arbitration. If that is not done, the prospective respondent may challenge jurisdiction at the outset or argue that the tribunal lacked jurisdiction at the enforcement stage and try to have the award set aside, causing significant extra delay and expense.

There may also be scope for disagreement as to exactly what steps are required by the clause in question (as occurred in the Emirates case itself) and whether those steps have been taken. When a dispute arises, parties should ensure there is enough 'open' evidence to show that any required steps have been taken: the content of negotiations is often without prejudice and inadmissible, and so it may be desirable to keep a separate record of when negotiations have taken place without containing the detail of what was said.

Lawyers advising business people in their contractual negotiations may have assumed that clauses requiring friendly discussion between parties before arbitration would not be enforceable, and may therefore have taken a somewhat relaxed view to the inclusion of such clauses in the contract. It is now clear that such clauses should be assumed to be enforceable and taken seriously. When negotiating such clauses, clients should consider whether they are really willing to have to go through such hoops before being able to arbitrate; and if so, their lawyers should ensure that the steps which are required are spelled out clearly.

Notes:

1 [2014] EWHC 2014 (Comm).
2 [1992] 2 AC 128.
3. [2002] EWHC 2059 (Comm).
4. [2012] 1 Lloyd's Reports 671.
5. [2013] Lloyd's Reports 11.
6. See fn. 1.

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