



# Contractual Dispute Resolution

## INTRODUCTION

Contractual disputes are time-consuming, expensive and unpleasant. They can destroy client/supplier relationships painstakingly built up over a period of time and can impact on the supply chain. They can add substantially to the cost of a contract, as well as nullifying some or all of its benefits or advantages. They can also impact on the achievement of value for money. It is in everyone's interest to work at avoiding disputes in the first place and this is mirrored in the Government's emphasis on improving relationships between the client and supplier through teamwork and partnering. Inevitably, however, disputes do occur and when they do the importance of a fast, efficient and cost-effective dispute resolution procedure cannot be overstated.

This guidance gives an overview of the main options that are available for the resolution of disputes. It is not a self-help guide to dispute management.

Good dispute management involves selecting and using the most appropriate resolution procedure available. When contemplating arbitration or ADR clauses/agreements or considering how to reach or enforce settlement, it is important to obtain legal advice.

In general terms the Government's objective is to ensure that relationships between the client and supplier are non-adversarial, that contracts contain provision for the resolution of disputes which are appropriate having regard to their nature and substance and that such provision should, so far as possible, ensure that relationships with suppliers are maintained. In particular it is Government policy that litigation should usually be treated as the dispute resolution method of last resort.

On 23 March 2001 the Lord Chancellor published a formal pledge committing government departments and agencies to settle disputes by Alternative Dispute Resolution (ADR) techniques.

## THE ADR PLEDGE IN FULL

**Government departments and agencies have made the following commitments on the resolution of disputes in which they are involved:**

- Alternative Dispute Resolution will be considered and used in all suitable cases wherever the other party accepts it.
- In future, departments will provide appropriate clauses in their standard procurement contracts on the use of ADR techniques to settle their disputes. The precise method of settlement would be tailored to the details of individual cases.
- Central government will produce procurement guidance on the different options available for ADR in government disputes and how they might be best deployed in different circumstances. This will spread best practice and ensure consistency across government.
- Departments will improve flexibility in reaching agreement on financial compensation, including using an independent assessment of a possible settlement figure.

There may be cases that are not suitable for settlement through ADR, for example cases involving intentional wrongdoing, abuse of power, public law, human rights and vexatious litigants. There will also be disputes where, for example, a legal precedent is needed to clarify the law, or where it would be contrary to the public interest to settle.

## DISPUTE AVOIDANCE

Given the expense and disruption caused to any contract when a dispute arises and the damage to client/supplier relationships, the importance of following dispute avoidance techniques cannot be over-emphasised. However, notwithstanding the emphasis on the desire to avoid dispute, officers should not act in a way which compromises departments' rights.

The first important step is to have clear wording in a contract that reflects the intentions of the parties. That wording should include provision for the appropriate dispute resolution techniques to be applied in the event of a dispute arising, with suitable arrangements for escalation. Bear in mind, however, that overly prescriptive provision may reduce the options available to parties if there is a dispute.

Once the contract is in place good contract management is key. Contract management techniques should include monitoring for the early detection of any problems. In any contract both parties should be required to give the earliest possible warning of any potential dispute and regular discussions between the client and supplier should include reviews of possible areas of conflict.

When a contract is initially established the importance of bearing in mind how the expiry of the contract is to be managed (especially if there is a need for ongoing service delivery, not necessarily by the contractor) should be borne in mind and reflected in the contract.

## DISPUTE MANAGEMENT

If a dispute arises, it is important to manage it actively and positively and at the right level in order to encourage early and effective settlement. Unnecessary delays and inefficiency can lead to rapid escalation of costs and further damage the client/supplier relationship.

## DISPUTE RESOLUTION

Dispute resolution, in its widest sense, includes any process which can bring about the conclusion of a dispute. Dispute resolution techniques can be seen as a spectrum ranging from the most informal negotiations between the parties themselves, through increasing formality and more direct intervention from external sources, to a full court hearing with strict rules of procedure.

Alternative Dispute Resolution is a commonly used term to include a range of processes which involve the use of an external third party and which can be regarded as an alternative to litigation. There is some debate as to whether arbitration is or is not a form of ADR. For the purposes of the Government pledge arbitration is a form of ADR. Negotiation and litigation are not forms of ADR. However, there is now some cross-fertilisation between litigation and ADR in that the Pre-action Protocols recently introduced into litigation, and intended to codify and streamline the pre-action conduct of the parties, emphasise the importance of parties taking steps to achieve a settlement where possible before issuing proceedings, whether by ADR or other means. A further example of helpful cross-fertilisation between procedures is that it is now becoming fairly common for parties to arbitration proceedings to agree to mirror relevant provisions of the Pre-action Protocols in those proceedings.

### Dispute resolution techniques include:

- Negotiation – the most common form of dispute resolution where the parties themselves attempt to resolve the dispute.
- Mediation – a private and structured form of negotiation assisted by a third party that is initially non-binding. If settlement is reached it can become a legally binding contract.
- Conciliation – as per mediation, but a conciliator can propose a solution.
- Neutral evaluation – a private and non-binding technique whereby a third party, usually legally qualified, gives an opinion on the likely outcome at trial as a basis for settlement discussions.
- Expert determination – a private process involving an independent expert with inquisitorial powers who gives a binding decision.
- Adjudication – an expert is instructed to rule on a technical issue – primarily used in construction disputes as set out in the Housing Grants, Construction and Regeneration Act 1996 where awards are binding on the parties at least on an interim basis, ie until a further process is invoked.
- Arbitration – a formal, private and binding process where the dispute is resolved by the decision of a nominated third party, the arbitrator or arbitrators.
- Litigation – the formal process whereby claims are taken through the civil courts and conducted in public. The judgments are binding on parties subject to rights of appeal.

Below is some more information about each method and an indication of its advantages.

## NEGOTIATION

Negotiation is by far the most common form of dispute resolution. The objective of sensible dispute management should be to negotiate a settlement as soon as possible. Negotiation can be, and usually is, the most efficient form of dispute resolution in terms of management time, costs and preservation of relationships. It should be seen as the preferred route in most disputes.

### Its advantages are:

- speed
- cost saving
- confidentiality
- preservation of relationships
- range of possible solutions
- control of process and outcome

If you are unable to achieve a settlement through negotiation, you will need to consider what other method or methods of dispute resolution would be suitable.

But remember it will still be possible or may be necessary to continue negotiating as part of or alongside other forms of dispute resolution.

## MEDIATION (INCLUDING CONCILIATION)

Mediation is negotiation with the assistance of a neutral third party. It is often referred to as 'structured negotiation'. It has all

the advantages of conventional negotiation as set out above but the involvement of the neutral can make the negotiation more effective. It should be seen as the preferred dispute resolution route in most disputes where conventional negotiation has failed or is making slow progress. Mediation is now being used extensively for commercial cases (including cases involving government departments), and frequently for multi-party and high-value disputes. Over 75% of commercial mediations result in a settlement either at the time of the mediation or within a short time thereafter.

Use of mediation has increased significantly since the introduction of the Civil Procedure Rules (CPR) in 1999. The CPR state that “Active case management includes ...encouraging the parties to use an ADR procedure if the court considers that appropriate.” CPR Part 26 includes specific provisions about using ADR. A number of courts, including the Commercial Court, frequently make ADR orders, even in the face of objections from one or more of the parties.

- **Format** – mediation is essentially a flexible process with no fixed procedures, but the format tends to be along the following lines. At an opening joint meeting each party briefly sets out its position. This is followed by a series of private and confidential meetings between the mediator and each of the teams present at the mediation. This may lead to joint meetings between some or all members of each of the teams. If a settlement is reached, its terms should be written down and signed.
- **Timing** – most commercial mediations last one day, with very few running for more than three days. A considerable number take place within a month of being initiated and this period can be shortened to days where necessary.
- **The mediator** – the mediator’s role is to facilitate negotiations. The mediator will not express views on any party’s position, although he/she may question the parties on their positions to ensure they are being as objective as possible about the strengths and weaknesses of their own and the other party’s/parties’ legal and commercial stances. The mediator will try to get the parties to focus on looking to the future and their commercial needs rather than analysing past events and trying to establish their legal rights. It is essential that the mediator has mediation training; it is not essential that the mediator has experience, or even knowledge, of the subject matter of the dispute. The most obvious method of identifying an appropriate mediator is to use the resources of an ADR organisation.
- **Participants** – the team attending the mediation should be kept as small as possible but must include a lead negotiator, preferably a senior executive or official within the organisation, with full authority to settle on the day without reverting to others not involved in the mediation. The lead negotiator should ideally not have been closely involved in the events relating to the dispute.

Where it really is not possible for the lead negotiator to have full authority to settle, the person attending must be of sufficient seniority that their recommendation on settlement is likely to be followed by whatever person or body makes the final decision. The fact that a binding settlement agreement cannot be reached on the day of the mediation and the reason for this should be made clear to the other parties in good time before the mediation.

Most mediation teams include a lawyer but a large legal representation on the team is rarely useful or necessary.

- **Preparation** – each party usually prepares a brief summary of its position (not just its legal case) for the mediator and the other party, with the key supporting documents. These are exchanged between the parties, and sent to the mediator, at least a week before the mediation. The parties should enter into a mediation agreement once the details of the mediation (eg place, time, name of mediator) have been agreed.
- **Approach** – most mediations go through a stage where it seems unlikely that there will be any useful outcome yet the majority settle, so optimism and determination to solve the problem is essential.
- **ADR organisations** – in many cases it is sensible to involve a neutral ADR organisation to assist in setting up a mediation and helping the parties to select a mediator. The advantages of their neutrality and of utilising their experience and advice, and the saving of the parties’ own time in dealing with the administration, will usually outweigh the cost.

## NEUTRAL EVALUATION

The aim of a neutral evaluation is to test the strength of the legal points in the case. It can be particularly useful where the dispute turns on a point of law.

Each side submits an outline of their case with an indication of what evidence they would be able to produce at trial. A third-party neutral, usually a retired judge or a lawyer, gives a confidential opinion as to what the outcome of a trial would be. This procedure can be carried out entirely on paper, saving the parties the time and expense of an oral hearing. The opinion can then be used as a basis for settlement or for further negotiation.

## EXPERT DETERMINATION

In expert determination, the parties agree to be bound by the decision of an expert in the field of dispute. This process can be useful where the dispute is about a technical matter. The expert will commonly be given powers to investigate the background of the dispute himself, rather than just relying on the evidence the parties choose to present.

## ADJUDICATION

The term ‘adjudication’ is used almost exclusively for dispute resolution under Part II of the Housing Grants, Construction and Regeneration Act (HGCR) 1996, and before the passing of that Act adjudication was not a recognised form of ADR. Under the HGCR Act construction contracts must include a provision for adjudication, with the adjudicator giving a decision within 28 days of referral. The adjudicator’s decision is binding until a final determination reached by agreement, arbitration or litigation, or the parties may take the adjudicator’s decision as final. For these reasons adjudication is different in kind from other forms of ADR, which are optional and less tied to a single subject area. Like litigation and arbitration, adjudication is an adversarial process.

## ARBITRATION

Arbitration is governed by statute, principally the Arbitration Act 1996. It is a process for resolving disputes in which both sides agree to be bound by the decision of a third party, the arbitrator. If court proceedings are begun by one party they will normally be stayed on the application of the other party relying on the arbitration clause. The agreement to arbitrate should be in writing. It can take the form of a clause within the original contract or can be made after a dispute has arisen. It is possible, as long as all parties agree, to amend an arbitration agreement at

any stage so that it better serves the needs of the parties. The Arbitration Act gives the widest discretion to the parties to decide between themselves how their dispute is to be resolved but provides a fallback position if agreement cannot be reached. Like litigation and adjudication, arbitration is an adversarial process. The grounds for appeal are limited.

**Its advantages are:**

- some control of process – parties/arbitrator can tailor procedures
- possible cost saving over litigation
- confidentiality
- parties can choose an arbitrator who is an expert in the relevant field
- resolution is guaranteed
- decisions are legally binding and enforceable

## LITIGATION

If the use of a consensual process is not provided for in the contract and cannot otherwise be agreed, the only alternative is litigation. Litigation will involve preparation for trial before a judge, and may well be a lengthy, drawn-out and costly process. Parties often agree a settlement before the case comes to court, but in some cases not before months or even years of effort have been spent on expensive preparatory work.

**Its advantages are:**

- possible to bring an unwilling party into the procedure
- solution will be enforceable without further agreement

**Its disadvantages are:**

- potentially lengthy and costly
- adversarial process likely to damage business relationships
- outcome is in the hands of a third party, the judge

Remember, the court can now refer parties to mediation or another form of alternative dispute resolution, if appropriate.

## FACTORS GOVERNING CHOICE OF PROCEDURE

This guidance has thus far described the dispute resolution procedures available including some of their advantages and disadvantages. The purpose of this section is to summarise how in practice the most appropriate procedure or procedures should be selected.

Dispute resolution procedures are selected either when the contract between the parties is negotiated or when a dispute arises. It should be noted that the contract negotiation stage is of the greatest importance since, if the parties agree in the contract to adopt certain procedures in the event of a dispute arising, one party cannot insist on the use of other procedures, or even other methods of implementing agreed procedures, without the consent of the second party.

In the fairly recent past most contracts, especially those between parties both based in England or Wales, contained very

simple dispute resolution clauses providing for disputes to be settled in the courts or, sometimes, by arbitration.

There was no express reference to negotiation and alternative dispute resolution had scarcely been heard of. In practice, of course, the parties frequently did try to negotiate directly before embarking upon the costly process of litigation.

The current recommended practice for more complex contracts at least, exemplified by the drafting of the dispute resolution machinery of the OGC Model Agreements (see below), is to provide a full framework for the escalation of disputes beginning with a reference to the project board, followed by negotiation between named representatives of the parties and thereafter, if necessary, recourse to a non-binding ADR procedure (primarily mediation) and, in the event of failure to agree a settlement, ultimate resort to litigation in the courts or, if preferred, arbitration. Arbitration is often the procedure of last resort where confidentiality is required and is regularly adopted in, for example, Ministry of Defence procurement contracts. The other main attraction of arbitration is the possibility of choosing an arbitrator or arbitrators who are experts in the field in question. Expert determination is a less formal alternative procedure to arbitration used primarily for making awards in limited technical areas.

Although the dispute resolution machinery of the OGC Model Agreements represents a good working model suitable for many applications, and not just for IT contracts, the approach adopted may not be appropriate in every detail for every government contract. For example, mandatory use of mediation where negotiation fails may not always be appropriate in contracts for the procurement of smaller-value goods and services where it is perhaps more likely that the contractor may elect to use the process in bad faith merely to delay settlement.

In such cases it may be preferable to include a provision for mediation which is triggered only where both parties desire it. Departments must exercise discretion in such matters especially since the Government's pledge requires the use of ADR techniques only in all suitable cases.

## ADR CONTRACT CLAUSES

Including ADR dispute resolution clauses in contracts allows the settlement process to begin at an early stage and obviates the frequent problem of persuading the other party to the dispute to engage in an ADR process. The ADR pledge requires that an appropriate clause be incorporated into all contracts.

## LAW

This guidance is drafted on the basis that the law of England and Wales applies and you should consult your legal advisers if the contract is made under the law of Scotland or Northern Ireland. Use of this guidance is not mandatory, but a statement of good professional practice. Departments should consider incorporating it into their purchasing and supply manual.

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