SQUIRE PATTON BOGGS

Compliance With Dispute Escalation Clauses – A Matter for the Arbitral Tribunal

Global – July 2022

Global

In the recent case of *C v D* [2022] HKCA 729, the Hong Kong Court of Appeal handed down a significant decision concerning dispute escalation clauses that will have far-reaching consequences in jurisdictions that have adopted the UNCITRAL Model Law on International Commercial Arbitration.

Contracts commonly contain escalation clauses requiring parties to engage in negotiation or mediation prior to initiating formal proceedings. These clauses are designed to facilitate dispute resolution, in the hope of avoiding expensive litigation or arbitration.

However, in the arbitration context, further disputes often arise when a party alleges that the escalation procedure has not been satisfied, with arguments as to admissibility and jurisdiction following suit.

Background

The contract before the court contained an escalation clause stating that:

- The parties should attempt, in good faith, to promptly resolve such a dispute by negotiation
- Either party may, by written notice, have such dispute referred to the CEO of the parties for resolution
- If the dispute was not resolved within 60 business days of the date of a party's request for negotiation, either party could refer the dispute to arbitration

Relevantly, the parties disagreed as to whether they were required to refer the dispute to the parties' respective CEOs prior to commencing arbitration.

At first instance and on appeal, C sought to set-aside an arbitral award in D's favour under Hong Kong legislation that adopts the UNCITRAL Model Law on the following grounds:

- The arbitral award did not fall within the "terms of the submission to arbitration" under Article 34(2)(a)(iii)
- With regard to Article 34(2)(a)(iv), the arbitral procedure, including contractual procedures preceding the arbitration, had not been complied with
- Whether on a proper construction of the dispute resolution provisions, the referral to the parties' CEOs was a condition precedent to arbitration

Findings of the Court

The court rejected all three grounds of appeal, stating that any disagreement concerning escalation clauses should be resolved by the arbitrators appointed by the parties, rather than the courts.

Central to the court's decision in respect of the first ground of appeal was the distinction between admissibility and jurisdiction of the tribunal. The court cited a number of cases from foreign jurisdictions, including the decision of the New South Wales Supreme Court in *The Nuance Group (Australia) Pty Ltd v Shape Australia Pty Ltd* [2021] NSWSC 1498, in which Rees J, in considering the equivalent provisions of the Commercial Arbitration Act 2010 (NSW), held that a challenge to a claim referred to arbitration on the basis that it was time barred was not a challenge to jurisdiction.

The court noted it was an over-simplification to say that an arbitral tribunal's decision on whether a condition precedent has been satisfied must be a jurisdictional one open to review by a court under Article 34(2)(a)(iii). Rather, one must consider whether it is the parties' intention that a question of compliance with a condition precedent be determined by the arbitral tribunal and, thus, falls within the terms of the submission to arbitration.

The court held that a question of compliance with pre-arbitration procedure "is best decided by an arbitral tribunal in order to give effect to the parties' presumed intention to achieve a quick, efficient and private adjudication of their dispute by arbitrators chosen by them on account of their neutrality and expertise." This approach accords with the decision in *Fiona Trust & Holding Corporation v Privalov* [2007] Bus LR 1719, where Lord Hoffmann stated that parties are likely to have intended that all disputes be decided by the same tribunal.

As to Ground 2 of the appeal, the court found that it was advanced on the same contention as Ground 1 and that, even if it were accepted that the phrase "arbitral procedure" covered pre-arbitration procedure, it was not the parties' intention that non-satisfaction of the pre-arbitration procedure would bar arbitration altogether.

Having reached the above conclusions, the court did not consider Ground 3 of the appeal.

Key Takeaways

The decision supports the view that procedural conditions to arbitration are bars to admissibility and, as such, are matters that only the arbitral tribunal can decide. Parties looking to exclude certain disputes from the remit of arbitration should expressly carve out those matters in their arbitration agreement.

Notwithstanding, arbitral tribunals can still ensure that escalation clauses are observed by refusing to hear a dispute until both parties have followed and complied with the contract terms.

The court's findings reflect an increasing propensity for courts to limit judicial interference in arbitral proceedings. This will come as a welcome relief to parties seeking to avoid possibly expensive and protracted litigation post the referral to arbitration and give finality to those matters that proceed to an award.

Given the Australian states and territories universal adoption of the Model Law, we expect this decision will be given substantial weight by Australian courts in matters concerning Article 34 and arbitral tribunals seated in Australia generally.

Authors

Melissa Koo
Partner, Perth
T +61 8 9429 7568
E melissa.koo@squirepb.com

Joseph Perkins
Associate, Perth
T +61 8 9249 7408
E joseph.perkins@squirepb.com