ARTICLE

Dispute Escalation Clauses and Conditions Precedent – What the Courts Say

In my previous article for the Q32022 edition of the Pulse, *"Resolving Your Construction Disputes in Hong Kong – What Are Your Options?"*, I briefly discussed "Tiered Dispute Resolution Mechanisms" (also known as "Dispute Escalation Clauses") and noted that there had been recent court decisions relating to the parties' compliance with such dispute resolution provisions, particularly where compliance with the dispute resolution mechanism is argued to a pre-condition or a condition precedent to initiating formal proceedings. This article takes a closer look at two recent cases, the decisions reached by the courts and the implications for parties to a construction contract in Hong Kong and further afield.

Condition Precedent

LexisNexis[1] describes a condition precedent as follows:

"A condition precedent in a commercial contract details an event which must take place before a contract, or a party's obligation(s) under a contract come into force. The contract, or the relevant obligation, does not become binding until the condition has been satisfied."[2]

A condition precedent is therefore a provision or condition in a contract which must be fulfilled for either the contract to be valid or certain contractual obligations to come into effect and is a mandatory pre-condition. A condition precedent may either be expressly described as such or, due to the mandatory nature of the specific wording of the contract, be a clear pre-condition to be fulfilled.[3]

Introduction

It is not uncommon for both public and private sector construction contracts in Hong Kong to contain tiered dispute resolution mechanisms or dispute escalation clauses. Such clauses usually require the parties to negotiate and/or mediate their dispute(s) prior to initiating formal proceedings such as litigation or arbitration.

Structured dispute escalation provisions are designed

[1] "Overview: About LexisNexis," LexisNexis (last visited15 November 2022): https://www.lexisnexis.com.hk/about-us/overview

[2] "Glossary: Condition precedent definition," LexisNexis (last visited 15 November 2022): https://www.lexisnexis.co.uk/legal/glossary/condition-precedent

[3] This is not a definitive legal definition but is the author's general understanding of the phrase or term.

primarily to facilitate early dispute resolution and thereby avoid expensive and time-consuming arbitration or litigation, which is ultimately in the interests of the parties.

Where the parties have entered into a contract that contains dispute escalation provisions – whether such provisions are to be strictly followed without deviation will depend on whether undertaking each stage in the process is a pre-condition to moving on to, or invoking, the next stage, in effect the undertaking of each stage becoming a condition precedent to its escalation to the next. If, based on the specific language of the contract, each stage is a condition precedent, any premature attempt to, for example, refer a dispute to arbitration before attempting to mediate, may be considered a breach of the dispute resolution process. Accordingly, disputes can arise when a party alleges that the escalation procedure has not been followed.

If the dispute escalation provisions are not drafted carefully and are not sufficiently clear and certain, they may be challenged as being unenforceable. This can lead to serious and costly consequences, including challenges to the arbitral tribunal's jurisdiction, the enforceability of the arbitral award or result in a stay of proceedings.

The following two cases illustrate these points.

C v D [2022] HKCA 729[4] (C v D)

Summary

The Court of Appeal in Hong Kong[5] ("the court") resolved the above questions by determining that any dispute in respect of dispute escalation provisions should, for the most part, be determined by the arbitrator, rather than the courts. Save for exceptional circumstances, findings made by the arbitral tribunal on the fulfillment of or compliance with escalation clauses should be final and binding and cannot be relied upon by a party to challenge the tribunal's final award.

Background

The contract before the court was between two satellite operators. The dispute escalation clause in the contract provided 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; and
- Any award shall be final and binding and the parties agree to waive any right of appeal against the arbitral award.

The parties disagreed on whether they were required to refer the dispute to the parties' respective CEOs prior to commencing arbitration.

C on appeal sought to set-aside an arbitral award in D's favour under Hong Kong legislation that adopts the UNCITRAL Model Law[6] on the following grounds:

- Ground 1: The arbitral award did not fall within the "terms of the submission to arbitration" under Article 34(2)(a)(iii);[7]
- Ground 2: With regard to Article 34(2)(a)(iv),[8] the arbitral procedure, including contractual procedures preceding the arbitration, had not been complied with; and
- Ground 3: 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 arbitral tribunal appointed by the parties, rather than the courts.

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[4] In The High Court of The Hong Kong Special Administrative Region Court of Appeal, Civil Appeal No 387 Of 2021 (On Appeal from HCCT No 24 of 2020), [2022] HKCA 729 (7 June 2022): https://legalref.judiciary.hk/lrs/common/ju/ju_frame.jsp?DIS=144748&currpage=T

[5] The High Court of The Hong Kong Special Administrative Region Court of Appeal.

[6] "UNCITRAL Model Law on International Commercial Arbitration (1985), with amendments as adopted in 2006," United Nations Commission on International Trade Law (last visited 15 November 2022): https://uncitral.un.org/en/texts/arbitration/modellaw/commercial_arbitration

[7] Article 34(2)(a)(iii) of the UNCITRAL Model Law on International Commercial Arbitration (1985), with amendments as adopted in 2006, at 19-20: https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/19-09955_e_ebook.pdf

[8] Article 34(2)(a)(iv) of the UNCITRAL Model Law on International Commercial Arbitration (1985), with amendments as adopted in 2006, at 19-20: https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/19-09955_e_ebook.pdf

Central to the court's decision in respect of the first ground of appeal was the distinction between admissibility and jurisdiction of the tribunal. In arriving at its decision, the court considered a number of cases from Hong Kong, United Kingdom, USA, Singapore and New South Wales in Australia,[9] as well as academic opinion[10] to determine the distinction between admissibility and jurisdiction.

With regard to Ground 1, the court took the view that 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).[11] Rather, according to the court, 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, therefore, 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."*[12]

In respect of 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 in respect of Grounds 1 and 2, the court did not consider Ground 3 of the appeal.

Based on the facts of the case and in the absence of any agreement to the contrary, the court upheld the decision at first instance that the pre-conditions to arbitration were concerned with the admissibility of the claim, rather than the jurisdiction of the tribunal and that the arbitral tribunal's partial award was not subject to review by the Courts under Article 34.[13]

The decision of the Hong Kong Court of Appeal in C v D is an important case of international significance and is likely to have far-reaching consequences in jurisdictions which have adopted the UNCITRAL Model Law on International Commercial Arbitration.

Children's Ark Partnerships Ltd v Kajima Construction (Europe) UK Ltd and another [2022] EWHC 1595 (TCC)[14] (Children's Ark)

Summary

In the English case of Children's Ark Partnerships Limited v Kajima Construction Europe (UK) Limited, Kajima Europe Limited [2022] EWHC 1595 (TCC), the Technology and Construction Court[15] (the TCC) held that despite a dispute resolution procedure clause (DRP clause) being a condition precedent to the commencement of litigation, the DRP clause was unenforceable because the relevant wording was neither clear nor certain.

Background

In 2004, Children's Ark Partnerships Limited (the Claimant) entered into a construction contract (the Construction Contract) with Kajima Construction Europe (UK) Limited (Kajima Construction) for the design, construction and commissioning of the Royal Alexandra Hospital for Sick Children in Brighton (the Project). The Claimant had signed a Project Agreement with the NHS Hospital Trust[16] for the design, construction and financing of the redevelopment of the Project.

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[9] In The High Court of The Hong Kong Special Administrative Region Court of Appeal, Civil Appeal No 387 Of 2021 (On Appeal from HCCT No 24 of 2020), [2022] HKCA 729, at paragraphs 29 to 41 (7 June 2022): https://legalref.judiciary.hk/lrs/common/ju/ju_frame.jsp?DIS=144748&currpage=T

[10] Ibid at paragraphs 42 and 43

[11] Article 34(2)(a)(iii) of the UNCITRAL Model Law on International Commercial Arbitration (1985), with amendments as adopted in 2006, at 19-20: https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/19-09955_e_ebook.pdf

[12] In The High Court of The Hong Kong Special Administrative Region Court of Appeal, Civil Appeal No 387 Of 2021 (On Appeal from HCCT No 24 of 2020), [2022] HKCA 729, at paragraph 63 (7 June 2022): https://legalref.judiciary.hk/lrs/common/ju/ju_frame.jsp?DIS=144748&currpage=T

[13] Article 34 of the UNCITRAL Model Law on International Commercial Arbitration (1985), with amendments as adopted in 2006, at 19-20: https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/19-09955_e_ebook.pdf

[14] In The High Court of Justice Business and Property Courts of England and Wales Technology and Construction Court (QBD), [2022] EWHC 1595 (TCC), Case No: HT-2021-000499 (22 June 2022): https://caselaw.nationalarchives.gov.uk/ewhc/tcc/2022/1595/data.pdf

[15] The TCC is a specialist court within the King's Bench Division of the Judiciary of England and Wales and is also part of the Business and Property Court. The TCC deals primarily with litigation of disputes arising in the field of technology and construction, and also procurement claims. See "Technology and Construction Court," Courts and Tribunals Judiciary of the United Kingdom (last visited 15 November 2022): https://www.judiciary.uk/subjects/technology-and-construction-court/

[16] "A hospital trust, also known as an acute trust, is an NHS trust that provides secondary health services within the English National Health Service and, until they were abolished, in NHS Wales. Hospital trusts were commissioned to provide these services by NHS primary care trusts and now by clinical commissioning groups. NHS trusts were established by the National Health Service and Community Care Act 1990 as the first step in setting up an internal market." See "Hospital trust," Wikipedia (last updated February 14, 2021): https://en.wikipedia.org/wiki/Hospital_trust

Clause 9.7 of the Construction Contract provided that no claim, action or proceedings shall be commenced against Kajima Construction after the expiry of twelve years from the Actual Completion Date (2 April 2007). Despite the fact that the limitation period would have expired on 2 April 2019, the parties agreed to a "standstill agreement" dated 29 March 2019 (which was subsequently varied on four occasions: 7 April 2020, 29 March 2021, 28 June 2021 and 27 September 2021) due to ongoing remedial works being carried out by Kajima Construction since December 2018. As such, the limitation period was extended to 29 December 2021.

The Claimant initiated legal proceedings on 21 December 2021 and issued an application seeking a stay of proceedings in order to pursue the DRP clause. On the same day, Kajima Construction made an application under Rule 11 of the Civil Procedure Rules (CPR)[17] to strike out/set aside the Claimant's claim on the grounds of failure to comply with a contractual alternative dispute resolution provision (i.e., the DRP clause), which was argued to be a condition precedent to commencing legal proceedings.

The issues for the TCC to decide were:

- whether the DRP clause gave rise to a condition precedent or whether it was a mandatory jurisdictional provision;
- whether the provisions of the DRP clause were enforceable;
- if enforceable, whether the provisions of the DRP clause was complied with by the Claimant in advance of issuing proceedings;
- whether Rule 11(1) of CPR[18] was engaged; and
- if Rule 11(1) of CPR was engaged, how should the TCC exercise its discretion.

Decision

The TCC considered *Ohpen Operations UK Ltd v Invesco Fund Managers Ltd* [2019] BLR 576[19] (*Ohpen*), which listed the circumstances under which the court may stay proceedings where a party seeks to enforce an alternative dispute resolution provision. These included:

- the obligation must be expressed clearly as a condition precedent to court proceedings;
- the alternative dispute resolution provision must be clear and certain by reference to objective criteria; and
- the court has discretion to stay proceedings which were commenced in breach of an enforceable dispute resolution agreement.

Although the TCC held that complying with a DRP clause was a condition precedent, providing for a sequence which must be followed before legal proceedings could be commenced, the TCC however, disagreed with the finding in *Ohpen* that an obligation must be expressed clearly as a condition precedent before the court will stay proceedings.

In this regard, the TCC confirmed in paragraph 58 of the judgment:[20]

"The court's task in interpreting the Construction Contract is to apply the ordinary and well known principles of contractual interpretation, i.e. to ascertain the objective meaning of the language used by the parties to express their agreement….

It is not necessary for the words 'condition precedent' to be used, as long as 'the words used are clear that the right to commence proceedings is subject to the failure of the dispute resolution procedure'…. It is necessary to have more than a mere statement that compliance with dispute resolution procedure is mandatory."

[17] Rule 11 of the UK Civil Procedure Rules, Part 11 – Disputing the Court's Jurisdiction (last updated January 30, 2017): https://www.justice.gov.uk/courts/procedure-rules/civil/rules/part11

[18] Rule 11(1) of the UK Civil Procedure Rules, Part 11 – Disputing the Court's Jurisdiction (last updated January 30, 2017): https://www.justice.gov.uk/courts/procedure-rules/civil/rules/part11

[19] *Ohpen Operations UK Ltd v Invesco Fund Managers Ltd* [2019] BLR 576.

[20] In The High Court of Justice Business and Property Courts of England and Wales Technology and Construction Court (QBD), [2022] EWHC 1595 (TCC), Case No: HT-2021-000499, partial extract from paragraph 58, with case references removed for clarity (22 June 2022): https://caselaw.nationalarchives.gov.uk/ewhc/tcc/2022/1595/data.pdf

Furthermore, the TCC reiterated that it has an inherent jurisdiction to stay proceedings for the enforcement of alternative dispute resolution when the clause in question creates a mandatory obligation and where it is enforceable.

Nevertheless, the TCC held that the DRP clause in the current case was unenforceable because it was neither clear nor certain, and outlined various reasons for reaching its conclusion, including:

- there was no meaningful description of the process to be followed regarding the alternative dispute resolution;
- there was no unequivocal commitment to engage in any particular alternative dispute resolution procedure;
- there was a lack of certainty and it was unclear how a court was to decide which party was in compliance or in breach;
- the provision did not define "Liaison Committee";
- the Liaison Committee was to comprise only of representatives from Brighton and Sussex University NHS Trust and from the Claimant, with a provision for others to be invited to attend. Since there was no representation on the committee by the defendants, the process would not have final or binding effect and so was "rendered pointless"; and
- it was unclear when the condition precedent is satisfied and when the process was intended to come to an end.

Based on the above reasoning, the TCC concluded that the obligation to refer disputes to the Liaison Committee was not defined with sufficient clarity and certainty. Accordingly, the strike out and abuse of process applications failed.

The above decision of the TCC is a clear reminder to parties to be particularly diligent when negotiating and drafting dispute resolution escalation provisions. In particular, in respect of any condition precedent in respect of a tiered dispute resolution mechanism, the wording of such provisions must be clear and unambiguous.

Notwithstanding the above, the Court of Appeal in England and Wales[21] has recently granted permission to appeal the TCC's decision at first instance. Accordingly, the final outcome as to whether an alternative dispute resolution clause is considered to be a condition precedent to the commencement of legal proceedings is yet to be determined in Children's Ark.

Key Take Aways

A review of the two featured cases generally reflects the growing trend of the courts to minimise judicial interference with the dispute resolution process by seeking to give effect to the bargains struck by the parties in their agreements.

The decision in C v D established that disputes regarding conditions precedent to arbitration proceedings in dispute escalation clauses to be matters relating to admissibility of the dispute, rather than the jurisdiction of the arbitral tribunal, thus reducing the opportunity for parties to challenge the arbitral process or the award on jurisdictional grounds.

Whilst the issues featured in this article have been addressed in other jurisdictions, the Hong Kong Court of Appeal's decision in C v D is the highest authority on this issue from a UNCITRAL Model Law jurisdiction and will likely be followed outside of Hong Kong. It will be interesting to see the extent to which the Hong Kong Court of Appeal's decision in C v D is considered by the Court of Appeal in England and Wales, which has recently granted permission to appeal the TCC's decision in Children's Ark.

The decision in C v D provides certainty to parties seeking to avoid potentially expensive litigation regarding this type of jurisdictional challenge following referral of the primary dispute(s) to arbitration and will provide comfort that the matters referred will proceed to an award by the arbitral tribunal.

The decision in C v D does not however alter the position where the parties agree that certain pre-conditions, or conditions precedent to referring disputes to arbitration are subject to the arbitral tribunal's jurisdiction. If this is the intention of the parties, clear and unambiguous wording needs to be included in the agreement preferably with strict time limitations which will assist in establishing whether such pre-conditions have been met.

[21] The Court of Appeal is "the highest Court within the Senior Courts of England and Wales, and deals only with appeals from other courts or tribunals." See "Court of Appeal," Courts and Tribunals Judiciary of the United Kingdom (last visited 15 November 2022): https://www.judiciary.uk/courts-and-tribunals/court-of-appeal-home/

As can be seen from the two cases above, multi-tiered dispute resolution agreements or escalation clauses have been under considerable legal scrutiny recently. It is imperative that if the parties to a construction contract include such provisions in their dispute resolution agreement, they are clear and unambiguous. If the parties intend for each tier in the process to be a condition precedent to escalating the matter to a subsequent tier, they should include express wording that effect.

The overriding message to parties entering into construction contracts from the two cases considered in this article is, that when drafting provisions for a multi-tiered dispute resolution procedure, the terms need to clearly reflect the parties' intentions and the wording of the respective provisions must be precise and unambiguous to ensure that provisions are enforceable by the courts, if challenged.

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