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Strategies for dispute prevention and management in commercial arrangements

Joanne Staugas

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ADR in the commercial environment

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'Even with goodwill and carefully drafted and prepared contract documentation, commercial disputes will arise. When they do, the result does not need to be determined by a court or an arbitrator.'

There is a wide variety of contracting methods. Contractual disputes are a reasonably common commercial occurrence and vary in complexity, duration and effect. Most people become involved at some stage in attempting to resolve disputes. It is important to appreciate the ability that one has to exert influence over the process and the commitment necessary to perform contractual obligations in a balanced and informed way, so as to assist the successful completion of a project.

An understanding of some techniques used in dispute prevention and management will enhance one's ability to deal efficiently and expeditiously with all manner of disputes. Good management of a dispute will significantly reduce its impact on productivity and profit.

There are strategies available to minimise the risk of commercial disputes. In all cases, prevention of disputes should be the objective. However, when one becomes embroiled in a dispute, there are options other than arbitration or litigation to assist the management of disputes and obtain early resolution. A particular example is mediation.

Prevention is better than cure

My work is increasingly concerned with advising clients on strategies for dispute prevention at an early stage, and assisting clients to identify and implement practical strategies for dispute management and dispute resolution. I have observed a trend, both in the commercial world and in the law, towards early dispute resolution.

In certain circumstances the law may impose obligations that require one to:

- act conscionably in negotiations and in the performance of contractual arrangements;
- co-operate to achieve the contractual objectives and contractually agreed outcomes; and
- participate in good faith in contract negotiations or the settlement of disputes.

The imposition of such obligations promotes early dispute prevention and minimises the risk of disputes.

Disputes can be managed

We do not live in a perfect world. Even with goodwill and carefully drafted and prepared contract documentation, commercial disputes will arise. When they do, the result does not need to be determined by a court or an arbitrator.

While at first it may seem that a dispute has the potential to threaten the contractual arrangement, failure can be averted by management of the dispute at an early stage, including early negotiations or some other form of dispute resolution other than arbitration and litigation, such as mediation, expert determination or neutral evaluation.

Codes of practice and resolution of disputes

Industry and the business community are developing and implementing codes of practice (codes) as a strategy for dispute prevention, management and resolution. Generally, such codes provide standards of conduct that require co-operative and conscionable behaviour. Their focus is on building better relationships and promoting openness in business dealings. Most codes have a dispute resolution scheme designed for cost effective and easy application in the particular industry to which they relate.

Most industries would benefit from ➢

➢codes providing standards of conduct that require co-operative and conscionable behaviour, thereby sharpening the focus on building better relationships and promoting openness in business dealings.

Preventing a dispute from arising

Disputes arise in many different ways. Most often they will result from:

- uncertain or unclear and poorly documented contractual arrangements;
- circumstances where there is no written contract;
- certain conduct during the course of precontractual negotiations and during the performance of the contract; or
- third party interference that impacts in some way on the performance of the contractual arrangement.

In my experience, critical factors in dispute prevention include:

- well planned and documented negotiations;
- a clear and precise written contract;
- ensuring that you have the right commercial fit with a compatible team of people, all with a clear understanding of the agreed contractual objectives; and
- a commitment to acting reasonably and in good faith, honestly and fairly.

Best practice in negotiations

In conducting negotiations one should:

- consider who is the best representative — one's representative should understand the issues and the parameters of the negotiations, what can and should be said, and any timing issues;
- consider an appropriate level of legal advice and/or representation depending on the complexity of the arrangements; and
- document the negotiations by keeping notes of meetings and telephone discussions, and confirming matters in letters and emails at significant points in the negotiations.

Benefits of a written contract

A clear and precise written contract is an important factor in dispute prevention because:

- the writing is evidence of the contract;
- the process of preparing and negotiating the contract compels the parties to consider the important issues relevant to their dealings;
- it may provide for early dispute resolution; and
- a well drawn contract will give the parties certainty and confidence in their future dealings.

If a dispute does arise, a written contract may reduce the costs of resolving the dispute.

Importance of a paper trail

Clear and accurate records of negotiations are important. A paper and electronic trail can have significant evidentiary value during the course of subsequent litigation.

Written records will assist to keep the negotiations on track, assist in the preparation of a written contract, allow recollection of what happened before the contract was signed, and provide a particular version of events should a dispute arise during the course of the arrangement or after the transaction is completed.

It is useful to keep a notebook for significant negotiations, to record times and places of meetings, who attended, what was discussed and, in particular, what was agreed upon and what remains to be considered. It is desirable to record any warnings given about difficulties with a particular transaction or aspect of a transaction, requests for independent or expert advice, assertions about a party's commercial experience, or understanding of the proposed contractual arrangement. Letters confirming significant aspects of the negotiations or the outcome of a meeting are extremely helpful.

It is worth following these record keeping practices during the course of the contractual arrangement to record material relevant to matters such as performance and payment, and to record any changes to the arrangement.

Being reasonable, fair and conscionable

The *Trade Practices Act 1974* (Cth) (the TPA) prohibits unconscionable conduct in contractual arrangements. Other provisions of the TPA and the State fair trading legislation prohibit misleading or deceptive conduct. Many contractual arrangements require the parties to conduct themselves in good faith and to co-operate towards achieving the contractual aim.

Section 51AC of the TPA prohibits unconscionable conduct as defined by a set of criteria that a court may take into account in contractual arrangements for the supply or acquisition of goods or services.

Some relevant criteria to which the court may have regard, are as follows.

Section 51AC(3) …

(a) the relative strengths of the bargaining positions … and

(b) whether … the business consumer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the supplier; and

(c) whether the business consumer was able to understand any documents …; and

(d) whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the business consumer … and

(e) the amount for which, and the circumstances under which, the business consumer could have acquired identical or equivalent goods or services from a person other than the supplier; and …

(f) the extent to which the supplier's conduct towards the business consumer was consistent with the supplier's conduct in similar transactions between the supplier and other like business consumers; and …

(i) the extent to which the supplier unreasonably failed to disclose to the business consumer:

  (i) any intended conduct of the supplier that might affect the interests of the business consumer; and

  (ii) any risks to the business consumer arising from the supplier's intended conduct (being risks that the supplier should have foreseen would not be apparent to the business consumer); and

(j) the extent to which the supplier was willing to negotiate the terms and conditions of any contract for supply of the goods or services with the business consumer; and

(k) the extent to which the supplier and the business consumer acted in good faith. ➢

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Business is required, in effect, to undertake due diligence of the businesses it deals with on a daily basis. Suppliers may be required to explain the likely impact of a particular contract to their customers. While the application of the section is limited to contracts / transactions of less than $3 million, and is unavailable to listed public companies, the impact is potentially considerable.

The consequences of failing to comply with s 51AC could be an award of damages or rescission of the contract — that is, the parties being put in the position they were in before they entered into the contract.

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Methods of contracting which promote dispute prevention

There is a wide variety of methods of contracting, and a variety of dispute resolution clauses are now available. The clause or the strategy ought to be specifically designed for the contractual arrangement under consideration. This could go well beyond a simple dispute resolution clause and enter into dealing with codes of conduct, partnering charters and workshops.

Issues to be addressed in the area of dispute prevention include:

- what is the relationship between the contracting parties;
- how the parties require their relationship to be regulated;
- how the parties allocate risk (the risk allocation that the parties intend is very significant in the selection of a suitable dispute resolution mechanism);
- what are the terms of the contract (this is also a significant consideration — are the parties entering into a fixed price contract for the delivery of a specified product within an agreed time frame, or are they entering into a long term supply arrangement?); and
- whether aspects that require agreement can be quickly determined by an independent expert, using arbitration or binding evaluation, if agreement cannot be reached.

In the construction industry two methods of contracting — partnering and project alliance contracting — are increasingly used. They are seen as encouraging a co-operative approach to achieving cost effective success with project outcomes. Many government sector projects are being undertaken by alliances of one form or another. Industry generally is embracing performance based contracting where the parties are encouraged by rewards for achieving defined outcomes.

A report on research undertaken by the University of Westminster in the UK has shown that it is not easy to engage in partnering in the construction industry. According to findings in the report, the benefits are not necessarily as transparent as some commentators imply.[2]

Partnering is not seen as a universal panacea for the construction industry's problems, as all firms and projects are unique. It is not possible to develop a single prescriptive model for successful partnering. Nevertheless, it is stated in the report that case studies indicate some common factors — the selection of appropriate personnel, ability to develop non-confrontational ways of working, and openness and flexibility in communications — generally underpinning successful partnering arrangements.

How to best manage and resolve a dispute at an early stage

Most often it is advisable to attempt early resolution of issues so as not to threaten or prejudice the contractual arrangement.

The contractual arrangement is not always clearly recorded. Disputes often concern the parties' understanding of how the arrangement is intended to operate. Some terms may be recorded in letters and notes of meetings, or may be oral. The parties' conduct in these circumstances is likely to be particularly relevant.

Factors relevant to the management of disputes so as not to threaten the success of a commercial arrangement include:

- clear and ongoing communication;
- maintaining the relationship;
- identifying issues and practical options for achieving resolution; and
- identifying practical strategies for optimising resolution that avoid the parties becoming entrenched in their positions.

Issues likely to arise for consideration include:

- the parameters of the potential

dispute — the facts, the commercial impact, the contractual position and notification requirements;
- the relevant contractual process, if any, and in what respect certain steps may be binding, such as termination of a contract;
- identification of a potential dispute at the earliest possible time and triggering the dispute resolution process;
- the appropriate level of exchange of information sufficient to equip the parties to deal with the dispute;
- appropriate levels of representation;
- opportunities for meetings or hearings; and
- the role of an independent dispute resolver.

Practical approaches to management include:
- resisting behaviour that encourages the parties to become entrenched in their positions;
- training staff in best practice in negotiations;
- incorporating a dispute resolution clause in contracts to provide for early negotiation and/or mediation; and
- considering mediation.

An increasingly used method of dispute management is the dispute review committee or board of management specifically established in an industry, such as the construction industry, to deal with disputes as they arise. Typically, such a committee or board will be comprised of a representative/s from each contracting party and the superintendent (if there is one). The procedure for referring and dealing with complaints or disputes will be set out in the dispute resolution clause.

Another approach is the appointment of an expert or a panel comprising representatives from industry who are experts in their fields. The effect is to extend the current use of experts as advisors to the parties, to a wider and more direct role as advisors to the project concerned with its progress, and to provide quick and cost effective solutions to problems as they arise.

Training staff in negotiations

The TPA's procedural requirements for conscionable conduct in commercial dealings render the negotiation of a contract a significantly more difficult and risky matter than it may have been in the past.

It is worth considering training negotiators to better assess the risk of a breach of s 51AC of the TPA. Some assistance can be obtained from the Australian Competition and Consumer Commission's (ACCC's) *Guide to Unconscionable Conduct in Business Transactions*[3] which sets out a checklist at pp 36-7 based on s 51AC(3) and (4).

Other matters to be aware of in conducting negotiations include:
- the relative understanding by the parties of the documentation used;
- any protests expressed about the requirement for a particular style of contractual arrangement;
- any question of undue influence by an outside party, such as guarantors or financiers;
- whether the price or pricing mechanism is more favourable than the market price and, if this is so, why it is so; and
- whether one intends to act in a way the other party does not expect and why.

Dispute resolution clauses

There are many different forms of dispute resolution clauses available. Those clauses are often included in written contracts without any particular consideration given to their operation or effect.

Dispute resolution clauses and strategies ought to be specifically designed for the contractual arrangement under consideration. One of the great advantages of dispute resolution clauses is that they overcome the hurdle of a perception of weakness on the part of the party suggesting negotiation or mediation.

Enforceability of ADR clauses in contracts

ADR clauses are sometimes criticised because of the apparent ease with which they can be circumvented — for example, by one party simply adopting an uncooperative stance. It is often said that nothing prevents a party simply 'going through the motions', with no intent of reaching any resolution.

What has become known as a 'good faith clause' was developed partly in response to this perceived problem. The purpose of such a clause is to ensure that parties who attend mediation do so in an attempt to reconcile their differences. A common clause reads as follows:

> Each party confirms that it enters into this mediation with a commitment to attempting in good faith to negotiate towards achieving a settlement of the dispute.

But there are some difficulties with incorporating obscure concepts like these into contracts. Those concepts introduce a level of uncertainty in commercial arrangements and it is difficult to define and enforce them.

The NSW Supreme Court considered alternative dispute resolution (ADR) clauses in two building cases. In *Hooper Bailie Associated Ltd v Natcon Group Pty Ltd*,[4] the Court held that agreements to conciliate or mediate will be binding on the parties and enforceable in principle if the conduct required of the parties is sufficiently certain.

On the other hand, in *Elizabeth Bay Developments Pty Ltd v Boral Building Services Pty Ltd*[5] the enforceability of ADR clauses was to some extent undermined. In the *Elizabeth Bay* case, Giles J (the judge in both cases) refused to enforce the mediation clause on two grounds:
- the mediation arrangement provided was not sufficiently certain to be enforced; and
- the purported obligation to negotiate in good faith involved a 'formidable legal difficulty'.

He was not prepared to enforce the clause because, in his view, it rendered the contract void for uncertainty.

The NSW Supreme Court has recently confirmed the requirement for certainty. In *Morrow v Chinadotcom Corp*,[6] the Court dismissed an application for a stay of proceedings (brought on the basis of the existence and effect of a dispute resolution clause in the contract between the parties) because the dispute resolution clause did not possess the necessary degree of certainty of operation.

The Court said that the kernel of the process set out in the clause lay in the requirement that an

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► unresolved matter 'be referred ... for dispute resolution to the Australian Commercial Disputes Centre [ACDC]'. On the basis that the ACDC is purely a facilitator that assists parties to choose and implement their own dispute resolution process, and does not itself resolve disputes, the Court held that the dispute resolution clause lacked 'the kind of certainty as to procedure and process which the authorities make an essential ingredient of positive exercise of the jurisdiction to order a stay'.

This is not to say that the dispute resolution process must be specified in precise detail. The Court has held, in *Aiton v Transfield*,[7] (discussed below in relation to the good faith issue) that the process does not need to be 'overly structured', on the basis that 'if specificity beyond essential certainty were required, the dispute resolution procedure may be counter productive as it may begin to look much like litigation itself'.

While nobody can be forced to mediate, the majority of corporations in today's business world recognise the benefits of conducting themselves by fair and reasonable principles; particularly when there are long term arrangements in place and both parties have much to lose from resorting to legal action.

Good faith and best endeavours

Maintenance of good faith in the negotiating process is not inconsistent with self-interest. This was clearly stated by Einstein J in *Aiton v Transfield.*

> Good faith does not require a party to make concession upon concession. Clearly, good faith negotiation is not the equivalent of agreement, it is not a synonym for settlement, and does not require any particular outcome.[8]

Einstein J listed what he considered to be a non-exhaustive list of elements of an obligation to negotiate or mediate in good faith:

1. to undertake to subject oneself to the process of negotiation or mediation (which must be sufficiently precisely defined by the agreement to be certain and therefore enforceable);
2. to have an open mind in the sense of:
   (a) a willingness to consider such options for the resolution of the dispute as may be propounded by the opposing party or the mediator, as appropriate,
   (b) a willingness to give consideration to putting forward options for the resolution of the dispute.

The obligation to negotiate or mediate in good faith does not oblige nor require the party:

(a) to act in the interests of the other party;
(b) to act otherwise than by having regard to self-interest.

Incorporation of a requirement of good faith has many benefits. It implies that the parties have obligations to each other beyond their contractual rights and requires parties to work together to resolve their disputes.

Industry based codes of conduct

Many industries have introduced codes of conduct to regulate the commercial arrangements of participants. One of the reasons behind such an approach is dispute prevention. The business community recognises that a fair deal in an environment encouraging fair play, openness and co-operation will be a better deal for all concerned and pose less risk of a dispute occurring.

Another reason is the high cost of dispute resolution, not only because of fees paid to legal advisers but the cost to business in terms of lost productivity and the impact this has on profit margins. As the cycle trends through economically tough times and profits are hard earned, schemes that improve dispute prevention also improve the bottom line.

The banking and finance industry led the charge in the early 1990s and, in more recent times the *Franchising Code of Conduct* and the *National Electricity Code* have been introduced.

National Electricity Code

The National Electricity Code Administrator Ltd (NECA) is a company established by the five jurisdictions participating in the national electricity market, namely the States of Queensland, NSW, Victoria, SA and the ACT. NECA requires any person or entity registered with the National Electricity Market Management Company Ltd (NEMMCO) as a market ►

generator, trade or market customer (as defined by the *National Electricity Code* (Electricity Code)) to establish dispute management systems consistent with NECA's criteria.

The main functions of NECA are:

- to supervise, administer and enforce the Electricity Code;
- to administer the ongoing development of, and changes to, the Electricity Code to achieve market objectives;
- to establish ADR arrangements for the national electricity market;
- to review the arrangements for transmission and distribution pricing;
- to effectively liaise with other regulating bodies in the national electricity market, such as the ACCC and State regulatory authorities, in order to ensure consistent and effective development and application of the Electricity Code; and
- to collect information and statistics, publish reports and disseminate information relating to the performance of the national electricity market.

NECA's criteria for a dispute management system are set out in the Electricity Code. The criteria envisage that the system involves a two phase process:

- phase A — informal commercial negotiations; and
- phase B — more formal dispute resolution processes involving a third party to facilitate a resolution or make a decision on the issues.

Franchising Code of Conduct

Elements of the *Franchising Code of Conduct* (Franchising Code)[9] became effective from 1 July 1998 and the remainder became effective from 1 October 1998.

The Franchising Code provides guidelines and rules of conduct for participants in the franchising industry. The ACCC is responsible for the enforcement of the Franchising Code and breaches invoke sanctions under the TPA.

The franchising industry has been beset with difficulties, as evidenced by an ever increasing number of successful cases against franchisors under s 52 of the TPA. The Franchising Code has been seen as a response by government to the growing importance of the franchising industry to the Australian economy.

The Franchising Code requires franchisors to provide a disclosure document to prospective and existing franchisees on renewal and extension of an agreement, and when a franchisee materially changes an existing franchise agreement. It imposes obligations on franchisors to keep franchisees informed of certain information within their knowledge that may have an adverse impact on the franchisee or the franchise system.

Part 4 of the Franchising Code provides a mandatory dispute resolution process that is based on encouraging parties to select a means of settling the dispute that will produce a fair result, and requires the parties to identify the means of avoiding future disputes. If a franchise agreement already contains a dispute resolution process, that internal process should be used in the event of a dispute. However, if there is no dispute resolution process set out in the agreement between the franchisor and the franchisee, then Pt 4 of the Franchising Code will apply. All franchise agreements entered into after 1 October 1998 must contain a dispute resolution process.

Dispute resolution adviser

Both the Franchising Code and Electricity Code provide for the appointment of a dispute resolution advisor — in the Franchising Code the terminology used is a mediation advisor — to assist participants to resolve disputes without recourse to litigation.

Industry based dispute resolution schemes

A useful article has been written on industry dispute resolution (IDR) schemes that sets out a number of schemes that have 'proliferated like subpoenas at a Royal Commission'.[10] Those schemes include:

- Australian Banking Industry Ombudsman (ABIO);
- Telecommunications Industry Ombudsman;
- General Insurance Enquiries and Complaints Scheme;
- Life Insurance Complaints Service (LICS);
- Credit Union Dispute Reference Centre;
- Financial Planning Association Complaints Resolution Scheme;
- Insurance Brokers' Association Dispute Facility; and
- Complaint Resolution Committee, established by the Australian Timeshare and Holiday Ownership Council Ltd.

The article discusses the basic structure and operation of the schemes, the schemes' advantages and weaknesses, and how to use the schemes. While I do not agree with some of the conclusions, and also have some issues concerning the *Benchmarks for Industry Based Customer Dispute Resolution Schemes* document[11] held out as establishing objective standards for the administration of ADR, the document has some very useful information about these schemes.

Another process that has been discussed in literature in the construction industry but has not yet appeared much elsewhere is the use of dispute review panels or boards. This process is an interesting concept and is, in effect, an extension of privatised justice. It involves the appointment of panels comprising representatives from industry who are experts in their fields, extending the current use of experts — as advisors to the parties — to a wider and more direct role — as advisors to the project concerned with its progress, and providing quick and cost effective solutions to problems as they arise.

Conclusion

Dispute prevention and management are very much about strategies for negotiation and compromise. There is a growing emphasis on the use of dispute management techniques at an early stage. All aspects of dispute prevention, management and resolution are influenced by principles of trust, openness, flexibility and clear communication. Increasingly, the law is recognising the importance of conscionable conduct and upholding the enforceability of good faith requirements in contracts, all of which promote early dispute prevention and minimise the risk of disputes. ●

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Committee. Ms Staugas can be contacted at: S@finlaysons.com.au.

Endnotes

1. This is an edited version of a paper presented at the Asia Pacific Mediation Forum, Adelaide, November 2001.
2. See University of Westminster *Towards Positive Partnering: Managing Client Supplier Relations In Construction — Final Report To The Economic And Social Research Council* (1996) at: <www.bus.ed.ac.uk/ESRC/project_1n.html>.
3. ACCC *Guide to Unconscionable Conduct In Business Transactions* October 1998 at: <www.accc.gov.au/smallbus/unconscionable_conduct.html>.
4. (1992) 28 NSWLR 194.
5. (1995) 36 NSWLR 709.
6. [2001] NSWSC 209.
7. [1999] NSWSC 996.
8. Above note 7 para 156.
9. *Trade Practices (Industry Codes — Franchising) Regulations 1998*.
10. B Slade and C Mikula 'How to use industry based consumer dispute resolution schemes ... and why' *NSW Law Society Journal* February 1998, 58.
11. Department of Industry, Science and Resources *Benchmarks for Industry Based Customer Dispute Resolution Schemes* 18 August 1997.

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