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Escalation Clauses – Where Do They Leave the Counterclaimant?

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In a judgment of 24 May 2017 (*Biogaran v International Drug Development*, case n° 15-25.457), the commercial chamber of the French *Cour de Cassation* (Supreme Court) considered the question of whether a counterclaimant is bound by the requirements of a "multi-tier" dispute resolution clause. The clause in question required the parties to mediate as a precondition to court proceedings, but the court ruled that the defendant could nevertheless pursue a counterclaim that had not been submitted to mediation.

Since at least 2003 (with the landmark judgment of a mixed chamber of the Supreme Court in case n° 0019.42), the French courts have been clear that escalation clauses are in principle capable of imposing negotiation, conciliation or mediation as a condition precedent to litigation or arbitration. However, they have been equally clear that these clauses will only have this effect if they are drafted in terms that are mandatory, unambiguous and sufficiently specific. The decision in *Biogaran v International Drug Development* is a novel application of this line of reasoning.

The case originated in a claim brought by Biogaran in the Paris commercial court for alleged non-payment of sums due under a pharmaceuticals contract. According to the contract terms, the parties were required to conduct amicable negotiations of any dispute for a period of 60 days. If this did not succeed, the dispute was to be submitted to a mediator who would have a further 60 days to attempt to resolve it, "*failing which the parties would submit to the jurisdiction of the Paris court*" (free translation).

Biogaran complied with the amicable dispute resolution and mediation requirements before filing its court claim. The defendant, International Drug Development, responded with a counterclaim for termination of the contract – an issue which had not been considered in the mediation. The Paris court of appeal held that the counterclaim was barred for failure to comply with a condition precedent.

In overturning this decision, the Supreme Court reasoned that at the time when counterclaim was made, the proceedings had already been "commenced" (as that term is defined in Article 53 of the French Code of Civil Procedure). It was therefore irrelevant whether the contract required a mediation as a condition precedent to the commencement of proceedings. The question was rather whether it specifically imposed a precondition to the filing of a counterclaim – and without express wording to this effect, the court was not prepared to find that it did.

A careful consideration of the wording of a multi-tier dispute clause is already a recurrent feature of French jurisprudence on the subject. In a number of cases, the Supreme Court has refused to let vaguely worded clauses stand in the way of a party's right of access to the courts, requiring, for example, that a contractual condition precedent must specify how the negotiation was to be conducted (see the decision of 29 April 2014, n° 12-27.004), and that it must be expressed in mandatory terms (see, for example, its decision of 29 January 2014, n°13-10833).

More recently, however, there have been a number of occasions on which the Supreme Court has found that the hurdle for imposing such a condition precedent has been met. A frequently cited decision is that of the mixed chamber of the Supreme Court on 12 December 2014 (*Proximmo v Arnal-Lafon-Cayrou*, n° 13-19.684, which has been followed, for example, in case n° 15-17.989 of 6 October 2016 and case n° 16-16.585 of 29 March 2017). The court held that a claim made by a firm of architects was barred because the claimant had not respected a contractual requirement to submit any dispute to conciliation by the order of architects before taking it to court. Notably, the court also held that this failure could not be remedied by the claimant submitting the dispute to the professional body while the litigation was on-going. The contractual requirement had to be complied with before the court action was started. Unlike in some other jurisdictions (such as England & Wales and Switzerland, to name only two examples), the French courts will thus not simply stay the proceedings in order to allow an escalation clause to be complied with – although if a claim is struck out, the claimant is usually free to start a fresh action once it has complied with the necessary preliminary requirements.

In *Biogaran* the court broke new ground in applying these principles to a counterclaim, but its reasoning is coherent with the previous jurisprudence. In *Proximmo v Arnal-Lafon-Cayrou*, the court's refusal to grant a stay to allow the claimant to remedy its default was motivated by the fact that (at least on the facts of that case) the mediation had to be conducted before the court was seized of the case, so a stay would not overcome the problem. In *Biogaran*, given that the court was already seized, the requirement no longer applied.

Biogaran is particularly interesting given the sparsity of decisions on this subject in other jurisdictions. Certain jurisdictions seem to have adopted a similar line to the French court – for example, the Kansas Court of Appeals in *Vanum Construction Co. Inc. v Magnum Block LLC* (case no 103,385 of 10 December 2010) decided that a contractual clause which required mediation "*as a condition precedent to arbitration or the institution [of] legal or equitable proceedings by either party*" did not oblige the defendant to mediate before filing a counterclaim, because the mention in the clause of the "institution" of proceedings referred only to the commencement of a lawsuit and not to the filing of a counterclaim. Conversely, in the context of a FIDIC Red Book dispute resolution clause, the Bulgarian courts (in decision No. 1966 of 13 October 2015, commercial case No. 4069/2014) upheld an arbitral award refusing to consider the contractor's counterclaims when the contractor had not first referred them to adjudication.

The English courts have adopted a more nuanced view, finding that as a matter of discretion they can exceptionally allow parties to bring additional claims (which presumably must include counterclaims) in the context of on-going litigation proceedings, without first complying with contractual dispute resolution provisions. The issue was considered by the English High Court, also in the context of a construction dispute, in the case of *Connect Plus (M25) Limited v Highways England Company Limited* [2016] EWHC 2614 (TCC). The claimant in that case argued that some of the issues before the court had not been considered by an expert, in breach of a contractual requirement. On the facts, the court disagreed, but it went on to say that if it were wrong, it would

"unusually" exercise its discretion against staying the proceedings to allow these issues to go to expert determination, because the allegedly "new" claims were too closely interwoven with the pre-existing claims to allow any sort of sensible division between them. It is clear from the judgment, though, that the more usual approach would be for the English courts to stay any new claims until the relevant contractual preconditions had been complied with.

The issue is also expressly dealt with in some arbitral procedural rules. For example, both the Institution of Civil Engineers Arbitration Procedure (rule 5.2) and the Construction Industry Model Arbitration Rules (rule 3.5) expressly grant the arbitral tribunal jurisdiction over issues that are connected with and necessary for the determination of the dispute, irrespective of whether there has been compliance with any condition precedent to arbitration.

Nevertheless, absent any guidance in the rules of arbitration or applicable case law, counterclaimants are still left with a large degree of uncertainty as to their obligations, particularly where (as is often the case) the wording of the contract is not crystal clear. And of course the question of the continuing relevance of an escalation clause after a court or tribunal has been seized is not confined to situations where there is a counterclaim. Parties who have complied with a contractual precondition in respect of one aspect of their dispute are often faced with the question of whether their compliance was extensive enough. Are they required to submit exactly the same claim to the court or arbitration tribunal as was considered in the negotiation, mediation or adjudication? Or do they have some latitude to amend their arguments or even add new claims at a later date? These questions are of quite some practical importance given that parties often only engage lawyers when they file for litigation or arbitration, so the nature of the dispute will frequently evolve at that stage.

Although one should not attempt to read too much into a single decision, particularly one that does not have the force of binding precedent, the reasoning of the French Supreme Court in the *Biogaran* case proposes an interesting approach to this question. It suggests that there is distinction to be drawn between preconditions to commencing proceedings and preconditions to joining additional claims to proceedings that have already commenced. At least when the escalation clause is worded in general terms, one might infer that once proceedings have been commenced, the clause is no longer applicable to additional claims between the same parties (counterclaims or otherwise). This has the advantage of ensuring that once proceedings have been started, the court or tribunal has more scope to determine all the issues between the parties in a single set of proceedings. Very often, this will give effect to the underlying aim of the parties when they agreed to the escalation clause – that their dispute be resolved efficiently and with a minimum of cost.

Nevertheless, as we have seen, the French courts will pay close attention to the wording of the escalation clause itself (as of course will tribunals and courts in other jurisdictions), so each case must be considered on its own terms.

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