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Drafting A Sensible And Effective Multistep ADR Provision

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Law360, New York (December 12, 2016, 4:37 PM EST) -- When businessmen (or their legal counsel) give much consideration to the dispute resolution provisions of their commercial agreements, they sometimes seek to delay engagement in adjudicative processes in hopes of achieving cost savings. The implicit thinking is that the longer one keeps the parties out of court or an arbitration proceeding, the more likely it is that they will avoid or reduce the costs of formal dispute resolution processes altogether.

Toward that end, parties frequently create a multistep ADR scheme, which may include some or all of the following steps as options or as pre-conditions before commencing arbitration: (i) "amicable negotiation," (ii) up-the-chain negotiations, (iii) advisory or adjudicative expertise, and (iv) mediation. But such schemes not infrequently represent the triumph of hope over practicality and business efficiency. The actual results of such a regime may include unnecessary delays and expenditures, issues left unresolved for extended periods, and deterioration of commercial relationships, which may become less productive or less functional, if not fractured or moribund.

The following is some practical advice regarding factors to be accommodated in fashioning multistep ADR provisions that are (i) useful and (ii) likely to be enforced by the courts. Among other things, we comment on the utility or lack of utility of some of the above-mentioned non-adjudicative steps, and regarding circumstances in which a multistep dispute resolution process makes more or less sense.

Enforceability of Multistep Dispute Resolution Provisions

Courts generally will enforce a multistep ADR clause if (1) it is sufficiently detailed to create legally binding obligations, and (2) it provides objective criteria by which to assess claims of breach. Setting out detailed terms and procedures, such as those suggested below, will go far to assure judicial enforcement of such provisions.

Critically, if any specified pre-arbitral step is to be a condition precedent to the commencement of arbitration, it would be prudent if not essential to state that expressly.

A "Negotiations" Step

We submit that including a "negotiation" step in a contractual ADR provision is generally unnecessary and unproductive. Informal discussion should be and is a means that is always available to the parties under virtually all conditions. Hence, there is nothing to be gained (and time to be lost) in specifying "amicable negotiations" or an "up-the-ladder" negotiation in a dispute resolution clause, which should focus on formal processes.

"Amicable negotiations" — a phrase used to signify politesse in the extreme — are simply voluntary discussions. (It does not signify that brass knuckles are barred from the negotiations.) "Up-the-ladder negotiations" is a scheme requiring the successive escalation of the seniority of

participants to defined levels in each company's hierarchy until a settlement is reached or the ladder is exhausted. It not infrequently includes putting each company's CEO in harness if the dispute is not resolved at a lower level. (But woe unto the person who actually has to tell the CEO of a company that he/she is required to negotiate a commercial dispute, unless it is a bet-the-company problem.)

The parties will virtually always make efforts to settle their differences before thinking about resorting to formal dispute resolution processes. There are no barriers or hurdles or special costs or formalities necessary to enter into such discussions. And the parties' respective staffing of their negotiating teams ought to be discretionary. (A company's internal politics may have an effect in this regard, but the notion that concealment of problems within an organization is a common barrier to settlement is largely mythology.)

Negotiations can and will be carried on by the parties whenever it seems potentially useful, including before, during and after adjudicative processes like arbitration. Hence, we submit that delaying the use of formal dispute resolution processes by requiring the passage of an additional defined negotiation period is usually pointless and wasteful.

An "Expertise" Step

The use of an expert to provide advisory opinions regarding certain issues may be useful to resolving disputes, particularly in a commercial relationship where multiple or prolonged performances are required, where technical issues can be anticipated, or where valuation issues are possible. In such situations, a pre-arbitration step allowing for (i) delegation of an issue to expertise, (ii) receipt of an advisory opinion from the expert, and (iii) a defined period of negotiation thereafter can be a practical scheme. Exhaustion of such a mechanism might even be made a prerequisite to the commencement of arbitration.

Whether an expertise advisory step is to be an option or a prerequisite prior to arbitration, the parties should consider including the following in their dispute resolution clause:

1. Is this measure a condition precedent to arbitration or an option that may be invoked prior to arbitration?
2. The scope or categories of issues that may be referred to expertise.
3. Initiation by any contracting party.
4. Pre-agreement on an individual expert or a panel from which an expert may be drawn in a set order (so that the unavailability of expert #1 permits resort to expert #2, etc.)
5. Period within which the expertise procedure may be initiated — if this process is not a prerequisite to arbitration, this might even be up to the time by which a respondent must answer after the commencement of arbitration.
6. Mandatory participation once initiated.
7. Expertise procedural rules, if any — e.g., ICC rules or guidance; or specific ad hoc rules.
8. Periods during which (a) the parties may submit information to the expert, and (b) the expert must provide an opinion or may request additional time to respond.
9. Consequences of non-participation of a party.
10. Specification of the non-adjudicative nature of the expert opinion.
11. Period during which subsequent negotiations must be concluded.
12. Agreement that the expert opinion is non-binding, may not be used as evidence in any subsequent dispute resolution proceeding, and is to be deemed a settlement communication under applicable state and Federal law.

One variation on the use of expertise — making an expert's opinion binding on the parties — should *not* be agreed without understanding that such a process would be treated in law as an ad hoc arbitration. The opinion most likely would be considered an award, and the issues in question would be deemed adjudicated.

A Mediation Step

Providing for mediation as an option or as a pre-condition before arbitration is often sensible,

particularly in connection with a long-term commercial relationship.

Whether a mediation step is to be an option or a prerequisite before arbitration, the parties should consider including the following terms in their contractual ADR provision:

1. Is this measure a condition precedent to arbitration or an option that may be invoked prior to arbitration?
2. Initiation by any contracting party.
3. Period within which mediation may be commenced — if not a prerequisite to arbitration, that might be up to the time by which a respondent must answer after the commencement of arbitration.
4. Mandatory participation once commenced.
5. Mediation rules — typically those of an ADR-administering institution like AAA, ICC, etc.; any ad hoc rules should be specified.
6. Maximum duration of mediation (subject to agreement to extend).
7. Method of selection of mediator (if not provided in chosen institutional rules).
8. Criteria for failure of mediation before expiration of permitted period.
9. Consequences of such failure of mediation.
10. Criteria for a participation default by a party before expiration of permitted period.
11. Consequences of such a participation default by a party.
12. Location of mediation.

A Few Comments Regarding "Med-Arb"

"Med-Arb" — a combination of mediation and arbitration processes — is an ADR variant that does not fit neatly into a multistep ADR scheme. In Med-Arb, a single person or a panel may act both as adjudicating arbitrator and facilitating mediator, and the order of employment of those processes is left to the discretion of that dual functioning person (or panel), not the parties. Thus, Med-Arb stems from the village elder tradition of dispute resolution.

In our view, a Med-Arb mechanism compromises both formal processes. First, the mediator's effectiveness is reduced by the natural reluctance of the parties to communicate candidly with someone who might eventually adjudicate their dispute. In the normal facilitative approach to conciliation, the mediator aims to obtain as much information from the parties as possible regarding their perceived strengths and weaknesses on the law and the facts; their commercial needs and wishes; their evaluation of the merits and the value of a settlement; etc. (This is to enable the mediator to suggest possible means to achieve settlement.) But parties will likely be reluctant to disclose such things candidly to a Med-Arb mediator. Indeed, it may be the obligation of the recipient of such information — wearing his arbitrator's hat — to disclose to all parties any information that is material to the arbitration, so as to assure that ex parte communications do not influence such an adjudication.

Moreover, a mediator does have an evaluative tool to employ, if necessary, in bringing the parties to agreement. That is, the mediator may give personal views, usually in private, regarding the strengths and weaknesses of a party's arguments; a personal view regarding the likely outcome of an eventual adjudication; etc. When the mediation and arbitration processes are separate, that may influence the parties in reaching conciliation without concern for its possible effect on an eventual arbitration. But if such a tool were employed by a mediator in a Med-Arb process, it might compromise the validity of a later arbitration because the arbitrator will have expressed a position on the merits before a full litigation of such matters in an arbitral proceeding.

In sum, the effectiveness of a facilitator/adjudicator in a Med-Arb scheme is likely to become compromised to one degree or another, in one respect or another, in both functions.

Conclusion

In all, a multistep ADR contract provision may be sensible and can be productive in several circumstances. However, attention to the details is necessary for assuring the enforceability and

the prospects for success of such a clause.

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