ARBITRATION, MEDIATION AND ADR: A PRIMER FOR OWNER MANAGERS

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Disputes are inevitable in business. Misunderstandings, misfortune, disappointed expectations and plain old greed and opportunism all play a role in creating disputes, but even honest, reasonable people can disagree. When business disputes occur owner managers want to solve them quickly, cheaply and "fairly", because they are massive distraction from core business and an unpredictable and uncertain drain on time and money. Since litigation is often considered a waste of time and money, as well as uncertain, it has become increasingly common to agree on an alternate dispute resolution process early in a commercial transaction. However, not all owner managers appreciate the differences between the various dispute resolution options that are available to them. In particular, many owner managers are not aware of some of the pitfalls of typical arbitration clauses.

Terminology: "Arbitration", "Mediation", "ADR" and "Litigation"

There are four main kinds of dispute resolution process. They are:

"Arbitration" – Arbitration is a private form of dispute resolution in which a neutral third party hired by the parties renders a decision after hearing from both sides. Arbitration can be binding or non-binding. If it is binding, no appeal to a court or higher authority is permitted. The arbitration process is normally agreed to between the parties on a contractual basis, in which they agree on the arbitrator, the rules of procedure that will apply, how costs will be apportioned, and that they will accept the outcome.

"Mediation" – Mediation is another a private dispute resolution process in which a neutral third party hired by the parties helps them reach a resolution to their disagreement. However, unlike arbitration, the mediator has no power to impose a decision upon the parties if they cannot reach an agreement with the mediator's assistance. If mediation does not produce a settlement, the parties are still free to pursue arbitration or litigation.

"ADR" *or* ***"Alternative Dispute Resolution"*** – This is just a catchall phrase for any form of dispute resolution other than litigation. It includes arbitration and mediation and any other contractual process the parties can agree to. In this context, shotgun clauses in shareholder disagreements are a form of ADR, as they are intended to create a process for parties in conflict to resolve their differences without resorting to court[1].

[1] Shotgun clauses present their own challenges, and are often used inappropriately. See the article *Shotgun Clauses and Owner Managers: Limitations and Alternatives*, on our website www.thompsonlaw.ca.

"Litigation" – This is a lawsuit or legal action in a court of law for the purpose of enforcing rights or obtaining redress or remedy. It is usually public, binding, and appealable to one or two levels of appeal. The court usually has a variety of judgements it can implement, including interpretations, damages, specific performance and injunctions.

Pros and Cons of ADR versus Litigation

There are a number of factors to consider when choosing your dispute resolution mechanism, whether as part of your contract or after a dispute arises. The more critical the contract or relationship is to your business, the more thought you need to give to choosing a good dispute resolution process.

Issue	Mediation	Arbitration	Litigation
Timing – Speed and Pace	Generally one to two months. The parties control the pace.	Generally four to twelve months. The parties have a significant say in the pace.	Can be as short as six months, but twelve to thirty-six months are more typical, not including appeals. Large or complex cases can last many years. The court controls the pace.
Costs Overall	Can be quite reasonable in terms of cost.	Usually no cheaper than litigation, and can cost even more depending on the case. However, because arbitration is usually quicker than litigation, the costs are compressed into a shorter period of time with more cash flow urgency.	Often no more expensive than arbitration. However, because litigation usually takes place over a longer period of time, costs can be spread out with less cash flow urgency.
Cost of Adjudicator and Facilities	Paid by the parties.	Paid by the parties.	Paid by the taxpayers.
Apportionment of Costs and Settlement Offers	Usually irrelevant, and each side pays their own costs.	Some clauses or rules of procedure simply have the parties split the costs no matter who was at fault or unreasonable. It is best to address this in the arbitration clause	It depends on the jurisdiction. The USA is quite different from Canada, for example. In Ontario, the general rule is that the loser pays about 50% to 65% of the

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		of your contract or in your choice of rules you agree to follow. If apportionment is permitted, settlement offers will be taken into account in dividing costs. Can give 100% recovery of actual legal costs.	winner's costs, so it is not complete indemnity. Also, in Ontario, settlement offers can be taken into account in apportioning costs, which could end up benefiting the loser or the winner depending on who made what offer to settle.
Finality	Only final if the parties reach an agreement.	Can be binding or non-binding, depending on wording of arbitration clause in the underlying agreement.	Will eventually produce finality, after appeal rights are exhausted.
Enforceability	Only enforceable to the extent parties agree.	Only enforceable to the extent the parties agree, or to the extent it is provided for in the rules of process chosen by the parties. Generally speaking, binding arbitration awards are enforceable, but this depends on the jurisdictions involved.	Generally speaking court judgements from major countries in proceedings to which the parties responded are enforceable anywhere that matters. However, the issue of jurisdiction is something to consider.
Formality	Up to the parties. Usually very informal.	Usually as formal as any court proceeding, but the parties can choose a more informal process if they can agree on one.	Very formal. The parties have no say on this issue.
Number of Adjudicators	Up to the parties. Usually only one.	Up to the parties. I recommend three for binding arbitration. After all, if we could always count on one person getting it right we would have no courts of appeal.	Usually one at trial, three on first appeal (usually a matter of right in commercial cases), and nine on ultimate appeal (rarely permitted in commercial cases).

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Neutrality of Adjudicators	Up to the parties.	Up to the parties. However, I recommend that all arbitrators be neutral and independent, otherwise you could simply end up with one side making the decision with no rights of appeal.	Supposedly guaranteed by the court process. However, it should not be taken for granted. US juries, for example, have a reputation of being biased against foreign companies. In international contracts, arbitration has become preferred to avoid the potential of bias when facing a foreign national in their own court system.
Expertise and Qualifications of Adjudicator	Up to the parties, as they choose the mediator.	Up to the parties, as they choose the arbitrators. However, be careful about automatically going with lawyers or retired judges. You can often find engineers, accountants or other experts who can add a lot more value to your case.	Particular expertise is very doubtful, and needs to be considered carefully. Most judges were lawyers in their previous life, which means they do not have depth of knowledge in many issues that could be germane to your situation. They may not even have been business lawyers when in practise. You should assume you will get an earnest layperson in whatever area you are disputing.
Choice of Law	Up to the parties to agree.	The parties can set the choice of law in their contract. If they do not, then the arbitration panel will have to decide which	The parties can set the choice of law in their contract. If they do not, then the court hearing the case will probably use the laws

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		jurisdiction's laws should apply.	of its jurisdiction. This can be advantageous to the first to sue if the parties are from different jurisdictions.
Place of Hearing	Up to the parties to agree.	The parties can choose in their contract. If they do not, the arbitration panel will decide based on the arbitration system they are following.	The parties can set the place of litigation in their contract. If they do not, the first to sue can choose the place of litigation, which everyone else will probably have to live with as long as the place chosen has some reasonable connection to the events in dispute, as decided by the judges in that jurisdiction. This can be an advantage to the first to sue if the parties are from different jurisdictions.
Choice of Rules and Procedures	The parties have to agree.	The parties have to agree. Normally specified in the contract that sets up the arbitration. Are various systems to choose from, as noted below.	The rules and procedures of the court in which the litigation is taking place will prevail. This can be advantageous to the first to sue if that party can choose the jurisdiction. For example, discovery rules, cost exposure and availability of juries in commercial case are very different in the USA than they are in Canada.

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Availability of Interim Relief	Irrelevant in a mediation as the mediator has no decision-making power.	Can be available in arbitration, depending on the rules of procedure chosen by the parties. More common in litigation than in arbitration.	Readily available.
Publicity	Usually very private.	Usually very private. Parties can stipulate confidentiality as part of the arbitration process. Can be very helpful in cases surrounding sensitive intellectual property, for example.	As a general rule all court-based litigation is a matter of the public record. All court documents and testimony are open to the public, the press, competitors, employees, customers, suppliers and anyone else who is interested. Orders suppressing evidence are very rare in commercial litigation case. All cases in courts are subject to being reported in law journals.
Flexibility	Very flexible.	Somewhat flexible. Usually arbitration panel will do whatever the party wants, but not always. Can vary with the arbitration process.	Usually not very flexible at all.
Tendency to "Split the Difference"	Not unusual to "split the difference".	Not as much in mediation, but a greater risk than in litigation.	Courts in common law jurisdictions take a very principled and reasoned approach, are adversarial in nature, and do not mind results that produce "winners" and "losers".

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Adversarial Nature	Least adversarial, as emphasis is on reconciliation.	As adversarial as the parties want it to be.	As adversarial as the parties want it to be.
Allocation of Fault or Blame	Tends to be avoided, as finding fault is contrary to the spirit of mediation.	Parties can choose whether they want the arbitration panel to determine fault or blame. Parties can ask arbitrators for a decision only, without editorializing.	Depends on the case and the judge, but courts tend to be places where fault and blame are often the basis for deciding outcomes. The parties really have no say, as the judge will do whatever they think is best, especially if they think the case may be appealed by an unhappy litigant or if they think the case will be reported in law journals.
Reasons for Judgement	Usually are none. Can be a mediation report, if the parties ask for one, but it will not take sides.	Usually are reasons for judgement, though parties can limit the issues they want the arbitrators to address.	Always reasons of some kind. Up to the judge what to address and how to do it. Often-extensive review of facts, evidence and law that could be useful as precedent in other cases. Parties have virtually no say or influence.
Dispute Avoidance Value	The threat of mediation is not a deterrent. However, it can be effective in avoiding adversarial, expensive and time-consuming processes when the parties approach mediation with the right attitude, a genuine interest in trying to see things from the other side's	Can be an effective deterrent due to the expense, compressed timetable, and uncertainty of outcome, but it often depends on the nature of the parties and the matter in dispute. Tends to be a more effective deterrent to disagreement than litigation.	Rarely seems to be a deterrent to disagreement, other than the usual cost and delay issues.

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	perspective, and a willingness to compromise.		

There are pros and cons to each process. There is nothing "automatic" about any of them and they all have their time and place. You must choose the best one for the circumstances.

However, don't forget that arbitration and mediation require the prior agreement of the parties. Litigation is the only dispute resolution mechanism that does not require everyone's consent. If your agreement is bitter or nasty, and you do not have a pre-existing arbitration or mediation agreement, odds are that you are going to court and there is nothing you can do about it.

Arbitration: Hidden Pitfalls And Potential Advantages

In light of the recent trend toward making arbitration clauses a part of the "boilerplate" in every contract, I would like to comment on ***some hidden pitfalls in arbitration*** that clients often overlook.

Single arbitrator **–** Most standard arbitration clauses call for binding arbitration by a single arbitrator. If we could count on one person to always get things right we would not have courts of appeal. I am very leery of single arbitrators if there are no appeal rights. If the parties want binding arbitration, I recommend three independent arbitrators. It costs more, but if you lose than you lose because two out of three independent arbitrators disagreed with you. I also recommend avoiding the three-person panel where each party chooses one arbitrator and those two arbitrators choose the third one. That really ends up with one person making the decision. As mentioned, I recommend three *independent* arbitrators.

Expertise **–** One advantage of arbitration is that you can put people with useful expertise and experience on your panel. That advantage is lost if you simply run off to a senior lawyer or retired judge as your arbitrator. If you have an accounting case, use accountants as your arbitrators. If you want a lawyer or judge to decide your case, go to court. They will be current, free, and can be appealed.

No appeal – By now, I'm sure you can tell I am very leery about giving up appeal rights unless you have the right kind of arbitration panel. Nothing is worse than losing a case in circumstances where you feel the judge was biased, did not understand your case (or simply got it wrong), and you have no appeal rights.

Location of arbitration and nationality in international arbitrations – There are circumstances where you do not want to be "out of state". Beware of what laws apply in your arbitration, where the arbitration takes place, and the nationality of the arbitrators. Under some rules and procedures the arbitrators must be representative of the nationalities of the parties, with the deciding vote coming from a neutral country. If this is important to you, get it right in your arbitration agreement or contract.

Costs of arbitration **–** As noted above, in any serious dispute, arbitration is not cheaper than litigation but is payable over a shorter time frame. Beware of paying for the cost of three years of litigation in only six months.

However, despite those concerns, a properly constructed arbitration process has several ***potential advantages over litigation***, including:

Speed – When done properly, arbitration gets the whole matter resolved much faster than litigation.

Neutrality – The opportunity to select independent, neutral arbitrators cannot be overlooked, especially when dealing with international contracts and relationships.

Expertise – The opportunity to select decision-makers who actually have expertise in the matters at issue is also valuable.

Red-Tape Reduction – Some arbitrations are just as formal and process laden as any court based proceeding. However, they don't have to be. Arbitration can reduce time and cost.

Privacy - Finally, a big advantage of arbitration over litigation is privacy. Unlike court battles, arbitration can take place out of the view of the media, competitors, customers and other third parties. Depending on the sensitivity of the issues at play, this can be a significant advantage.

Different ADR Systems You Can Plug In To

There are many different arbitration and mediation systems you can plug into. They come with different rules and procedures. Here are links to the most common ones.

Ontario *Arbitration Act*
http://www.e-laws.gov.on.ca/DBLaws/Statutes/English/91a17_e.htm

Ontario's statutory code of arbitration process and procedure. A good basic system that can be incorporated into contracts by reference. It is still up to the parties to find and agree on the arbitrators, although the court can be asked to appoint arbitrators if the parties cannot agree. Can be made binding and non-appealable, and awards are easily enforced in Ontario courts.

ADR Institute of Canada
http://www.amic.org/index.html

A national, non-profit organization offering mediation and arbitration services to clients. The Institute comes with detailed rules and procedures, a staff to help organize things, and lists of approved mediators and arbitrators to choose from.

American Arbitration Association
http://www.adr.org/

An international, non-profit organization offering mediation and arbitration services, including multiple sets of detailed rules and procedures for different kinds of cases, a staff to help organize things, and lists of approved mediators and arbitrators to choose from. Most large USA companies insist on AAA arbitration or mediation in their contracts. If possible, negotiate for a three-member panel, one from Canada, one from the USA and one from a neutral country, or negotiate for one of the AAA sets of rules and procedures that incorporate such an approach automatically (e.g. the rules for complex, international, commercial disputes). The AAA is internationally respected, and can be the basis for arbitration or mediation for contracts with non-USA based parties as well.

International Chamber of Commerce
http://www.iccwbo.org/policy/arbitration/id2882/index.html

An international, non-profit organization offering mediation and arbitration services, including multiple sets of detailed rules and procedures for different kinds of cases, a staff to help organize things, and lists of approved mediators and arbitrators to choose from. The ICC is widely respected around the world and is generally accepted without question when dealing with European, Middle Eastern, African or Asian businesses.

A Closing Thought

In my practise as a business lawyer, I usually find that business disputes are a true test of character for my clients and their business associates. Ironically, it is often those parties who least need a dispute resolution process who spend the most effort on defining a fair, balanced, reasonable and cost-effective process as part of their contracts and agreements.

Be mindful of dispute resolution issues regarding yourself and the party on the other side. Business people who display a willingness to deal with dispute resolution formalities in a professional, practical and fair way at the outset of a transaction or relationship are usually the kind of business people who will never need to use it when a dispute or disagreement eventually arises.