Current News

When is the right time to try mediation, before, during, or after arbitration or court proceedings ?

The timing issue is one of the most difficult questions for companies or lawyers unable to settle disputes and was also the most hotly disputed at a recent seminar organized by the Geneva Chamber of Commerce, with the participation of companies like Nestlé, SGS and Firmenich that use mediation and arbitration.

The question heard the most frequently when discussing mediation and its potential is: When is the right time to use mediation?

Before addressing this timing issue, we need to clarify a terminology point, because it does affect the answer to our question. For the purpose of this article, we will refer to conciliation, when a neutral third party (judge, arbitrator or conciliator) attempts to bridge the gap between the legal positions of parties in dispute, while we will refer to mediation when a neutral third party tries to help the parties find a solution to the problem underpinning the conflicting positions adopted by the parties.

While conciliation will therefore normally be based on briefs setting the framework within which the conciliation takes place, mediation will most probably include aspects initially not covered by the parties' memoranda setting out their conflicting views.

When codes of civil procedures refer to conciliation attempts, then it is often assumed that this attempt will take place before full scale litigation is launched[1].

By contrast, laws dealing with mediation specify sometimes that it should be attempted at any stage of the proceedings, if the matter appears to be likely to lend itself to mediation[2].

However, more generally, the rules of the various mediation and arbitration centers are not much help in determining when mediation or conciliation should be attempted, and even when they address this issue, the rules are rarely conceived as compulsory.

One exception is when the parties wish to have a mediation agreement incorporated into an arbitral award. To ensure that the award will be enforceable worldwide under the New York Convention[3], some rules[4] require that the parties institute arbitration proceedings before reaching a settlement agreement during a mediation. Failure to do so could indeed make the award subject to attack on the basis that a dispute capable of being decided by way of arbitration no longer existed when the arbitration was instituted since the dispute was already settled by way of mediation; hence there would be no more issues capable of being incorporated into a real award.

The Croatian Rules of Conciliation[5] take, however, a different view. Are the Swiss overcautious or the Croats too pragmatic? The issue has not yet been decided by a Court!

Besides this possible need to institute arbitration before finalizing a mediation, there may be a need to start forthwith arbitration or court proceedings, for instance to interrupt a statute of limitations or to freeze certain assets, leaving no time for a prior mediation.

Preconditions, such as asking the other party to agree first on certain issues before accepting a mediation, are usually a very bad idea, because very often they prevent the mediation from starting at all. A better way of dealing with such situations is to request that those questions be put on the agenda of the first mediation meeting. If no solution is found at that time, the mediation can be interrupted with very limited expenses and loss of time. At least the parties get a chance to start the process, which in practice is the most difficult to achieve.

Rather than list a number of theoretical considerations, some examples of mediation before, during and after legal proceedings will explain why there can be no standard answer to the timing question.

1) Mediation before arbitration

Two situations will be described below, one where there was already a damage following an alleged breach of contract and one where a breach in the near future became likely.

[1] *See article 15.5 of the draft of the first Swiss Unified Civil Procedure Law in German under : http://www.ejpd.admin.ch/etc/medialib/data/staat_buerger/gesetzgebung/zivilprozess.Par.0001.File.tmp/entw-zpo-d.pdf*

[2] *See Geneva Civil Mediation Law:http://www.stswiss.com/shared/publications/Mediation_civile.pdf (in French, German, English, Italian, Spanish and Russian).*

[3] *Convention on the Recognition and Enforcement of Foreign Arbitral Awards – the New York Convention, signed on June 10, 1958, entered into force on June 7, 1959.*

[4] *Swiss Rules of Commercial Mediation of the Swiss Chambers of Commerce and Industry (http://www.swisschambermediation.ch).*

[5] *The Rules of Conciliation of the Croatian Chamber of Economy were adopted by its General Assembly on July 2, 2002 and published in Narodne novine N° 81/2002.*

a) "The international sale" example

A dispute involving several deliveries of a commodity arose. The price of said commodity had fluctuated considerably and the quality of the deliveries made had become a subject of controversy. The contract had then been cancelled by the buyer and damages resulted from the impossibility to sell the commodity on similar terms at the time when the cancellation became obvious.

The parties had raised all kind of claims and counterclaims, but had accepted to hold a mediation before proceeding with arbitration.

For the purpose of the mediation, only a summary statement of facts was prepared and a mediation session was held by a mediator in the presence of both parties and counsels. There were also several caucuses but no highly confidential information was exchanged.

The parties could not agree on some critical facts, which therefore had to be decided by an arbitrator, but the mediation enabled the parties to sort out numerous side issues and to agree on which facts were really relevant. The arbitrator had therefore only to establish the few decisive disputed facts and draw the obvious legal consequences to render his award.

A highly contentious and unclear situation was therefore clarified by the mediation and the briefs for the subsequent arbitration could be kept short and to the point.

During the subsequent arbitration proceedings, a one day hearing of key witnesses was sufficient. This was all it took to get to the award. None of this would have been possible without the intensive preparatory mediation session.

Once the arbitration proceedings were concluded, but before the arbitrator rendered his award, he called the parties' attention to the fact that despite the problems attributable in part to the attitude of both parties, he would have to render an award all for one or all for the other party, without being able to split the damages. He offered therefore a last chance for settlement, but the parties wanted the relevant facts established by the arbitrator with the full consequences drawn from such facts. There was therefore no room for a late conciliation attempt by the arbitrator.

This is an example of mediation before arbitration, which unfortunately did not resolve all problems, but it helped to shape the arbitration proceedings, which reduced massively the cost of arbitration and the duration of the proceedings. Both parties, their lawyers and the arbitrator benefited from the mediation.

b) "The false excuse" example

Another similar type of situation where an early mediation was by far the best approach occurred when a sales contract was concluded, subject to a number of conditions precedent. Before the closing took place, the interest rate went up and the deal became financially absurd for the buyer. Interest rate changes were, however, not a ground to rescind the contract. The buyer started therefore, looking, for all kinds of reasons to claim that the conditions precedent had not been fulfilled by the seller. And he did find some arguments that were at least good enough to confuse the issue and delay by years a decision as to whether or not the buyer was bound to pay the full purchase price.

This is the classic case where the parties will argue for years in lengthy legal proceedings (arbitration or judicial) based on "pacta sunt servanda" and on related issues, because the buyer would never concede that he was merely looking for excuses not to buy due to the fact that he could not get the financing in place. At the same time a seller feeling cheated of a good deal will insist on suing to enforce his rights.

In mediation proceedings, such issues are dealt with under the confidentiality rules, facilitating disclosure of facts, which would be in contradiction with positions asserted forcefully in writing. Mediation can also lead the parties to examine hypothetical solutions first, rather than to concede facts, which can be embarrassing. Such hypothetical approaches ultimately enable both parties to deal more efficiently with the real issues, rather than getting entangled in useless dialogue at a high cost for no real benefit in the end.

They will for instance agree to leave the initial dispute unresolved, but settle either the financial terms for cancelling the contract quickly, giving a limited compensation to the seller but enabling him to resell without losing time, or agree on some financial concession to take into account the higher financing costs, making the sale the best option for both parties. The parties could also decide to join forces to sell to a third party, with a split of the profit or loss compared to the non-executed contract that takes into consideration the withdrawal of the buyer from the signed contract.

The key in such situations is to be able to persuade the parties that a pragmatic approach is by far superior to the possibility of prevailing fully after long and costly legal proceedings.

2) Mediation during Arbitration (or court proceedings)

Quite often the parties cannot agree on mediation before arbitration, even if it would make sense, because too much frustration has been accumulated during the unsuccessful negotiations between the parties or their counsels.

In those cases, initiating arbitration and confronting the parties with the high costs of those proceedings and the delays suffered may have a sobering effect. Also hearing key witnesses may provide the answer necessary to get a better understanding of what really happened and why things went wrong.

a) "The missing contractual base" example

In one instance the parties failed in their settlement negotiations and were impatient to have the matter sorted out by the appointed single arbitrator. After the first exchange of briefs, the cost to the parties was already substantial and more importantly it was obvious from the schedule set by the arbitrator for the follow-up proceedings that no decision would be rendered in the near future. Yet the parties were sharing certain facilities and failure to agree on the split of the related cost until the final award would create a huge and increasing uncertainty. So the parties finally agreed to try mediation.

They were each asked to file, at the same time, a short brief summarizing what their problem was and why they believed it had occurred. The large files of the arbitral pleadings were excluded from the mediation proceedings because they had been drafted with a different focus in mind, i.e. prove that they were right in taking the position they had adopted. Just the main contract was to accompany the short brief.

One session was enough to lead the parties to imagine a fair contract for the future and then to apply the solution retroactively.

The presence of the mediator was necessary to help the parties extricate themselves from the positions adopted in the arbitration proceedings and also because of the personalities involved.

On the one hand there was a fairly blunt manager advised by a know-it-all lawyer who understood everything very quickly and who would already imagine "The Solution" long before any of the other participants, and on the other hand there was a client who was looking for guidance from his constantly hesitating lawyer, who always feared to make a concession that he might regret later.

It is only by having a neutral third party actively managing the conflicts resulting from these very diverse personalities that allowed the parties to really hear what they had to say to each other, to focus on their true needs and to finally agree on a common text.

One concentrated session was necessary because for commercial mediation to succeed the top management must get involved and the time that such managers can set aside to focus on only one issue is very limited by definition. But it was worth the exercise because otherwise it would have taken them years of further proceedings.

b) "The accumulated frustration" example

In another case, a relatively small dispute between two companies involving parties in Asia, in the USA and in Europe escalated to a highly complex arbitration. After the witnesses and the parties had been heard in the course of a two day session, it became quite clear how the frustration had built up and led to the arbitration proceedings. It became just as evident that the arbitration proceedings were no cure for those frustrations and that the outcome would be a shock for one of the parties, because the result would be totally out of proportion to the initial stake.

A suggestion that the arbitral tribunal should call the parties' attention to the merits of mediation in such a case was rejected on the basis that the arbitrators had been appointed to decide the issue, not to coach the parties to find best solution for them. This is a view that is also quite common among judges who consider that they have been elected to render judgments, and not to help the parties to find the best solution for them.

This example illustrates the difficulty for arbitrators or judges to tell the parties that they should look for help from some third party when they have been entrusted with the resolution of the dispute.

Some months after the award had been rendered, counsels for the parties were asked if they would have accepted to use mediation, even at a late stage in the arbitral proceeding, if suggested by the arbitrators.

Both parties said they would have indeed done so! But none of the parties or counsels would have dared to take the initiative to propose a mediation after the witnesses had been heard.

c) "The real estate division" case

In this case, the dispute was pending before the Court of Appeals. The proposed judgment, which looked quite different from the First Instance judgment, was accepted by all the judges. It was however obvious from the fact pattern that the judgment would not solve the long term problem of the parties. While it would say how the property should be divided according to the law, the legal solution was inappropriate given the particularities of the local situation. So it was suggested to the parties that rather than awaiting the judgment, the parties should try to mediate the case. The parties agreed despite the fact that it delayed the solution by several months. The parties sorted out their division of real estate problem rather quickly, but a lot of other old problems surfaced during the mediation. The mediator gave the parties time to move at their own speed rather than forcing them to agree quickly for statistical purposes.

The key in his case was that the proposal to mediate could not be made by either of the parties for fear of losing face. It could only come from the Court. But once it was made, it was accepted with gratitude by both parties, even at that very late stage of the judicial proceedings.

3) Mediation after arbitration (or judgment)

Sometimes, a judge or an arbitrator must decide issues of fact or law before the parties can gain control over their dispute again.

a) "The car accident" example

In one case an injured person in a car accident was suing the two insurance companies of the two drivers that were involved. One claimed no responsibility at all, the other claimed shared responsibility. This needed to be decided before being able to move on to the quantum.

In such a case, the first judgment on liability was perfectly appropriate and even necessary because the law had to be applied to decide how to split (or not) the liability between the drivers before mediation could be envisaged to sort out the quantum issue.

b) "The bankruptcy candidate" example

In another case, similar to the "International sale" example analyzed, the winning party could bankrupt the defendant on the basis of the award, following a sales contract for USD 150'000.- which was unjustly rescinded and which led to damages in the amount of USD 10'000'000.-.

The bankruptcy of the defendant company could have been achieved rather quickly, but it would have produced no assets, because the technology group would simply have lost its key engineers, without compensation for the creditors of the company to be bankrupted. Without its engineers, the company was worthless.

A "mediation-like" confidential procedure made it possible to disclose the consequence of a stubborn enforcement attempt of the award by the winning party, and on this basis the parties could agree on settlement terms more realistic than those resulting from the arbitration award.

Mediation may therefore be of use even after an arbitral award or a judgment.

4) Conclusion

Mediation should be tried without preconditions before arbitration or court proceedings whenever the parties can no longer communicate effectively, either because the other party is quite obviously trying to elude its obligations, or because the other party systematically misinterprets the communications, or refuses to focus on the real needs. The intervention of a mediator can also help where the clients' two lawyers have personal characteristics that makes communication between them impossible or very difficult.

In those cases, the parties should not wait and let the conflict escalate through nasty lawyers' letters, because the more "bad communications", the more difficult it will be to bring the matter back on the proper track.

Strangely enough, putting the mediation in motion early is often the most difficult to achieve in practice, because the parties tend to postpone the involvement of a third party (be it a mediator, conciliator, arbitrator or judge) until they are no longer on speaking terms.

Yet most commercial mediations do not cost more than EUR 5'000.- to EUR 10'000.-, because the managers involved do not have more time to invest in such proceedings, yet such mediations achieve positive results (even when they do not resolve all issues) in the vast majority of cases.

Once the relations between the parties have deteriorated to the point that the parties do no longer communicate, it is often difficult to persuade them to try mediation.

Those are the cases where the cooling-off period provided by the initiation of arbitration or court proceedings is necessary, but it does open the possibility of mediation during arbitration or court proceedings. This is particularly the case just after key witnesses or party statements during a hearing shed a new light on the proceedings.

It is often not even necessary to suspend the arbitration or the lawsuit. Long deadlines before the next procedural step are often sufficient to get the mediation going. This helps to counter the argument that mediation is only proposed to delay the proceedings. Mediation will often succeed quickly, or fail quickly. This is what makes it so cost-efficient.

Finally, judges or arbitrators should keep in mind that the parties are often not able to propose mediation even where it makes sense because of the fear of signaling weakness to the other party. This is why all participants in judicial proceedings, including arbitrators or judges, should propose mediation at any stage of the proceedings, whenever they have the feeling that it would lead to better overall results than arbitration or litigation!

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