The Case Against Misdirected Regulation of ADR

By Kathleen Bryan and Mara Weinstein

Regulations, no matter how well meaning, inevitably limit and constrain. In sharp contrast, the primary benefits of private dispute resolution include flexibility, creative evolutionary change and customization. This article will serve as a cautionary tale against the unintended negative consequences of misdirected regulation in the ADR field. While ADR may have moved into "mainstream" legal practice, it continues to develop and change in the United States and abroad. We will explore how the ADR profession effectively polices itself, and how any ADR regulations that use a one-size-fits-all approach could have negative long-term effects on ADR's further development and acceptance.

This article is primarily addressed at commercial ADR in the business-to-business context, where the essential element is party choice about the mechanism used and the level of procedural safeguards desired. We appreciate that in a few, very narrow and specific areas of law (particularly where a large power discrepancy exists between parties), limited regulation may be necessary. In those limited instances, we advocate for extreme prudence when regulating ADR.[1]

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Introduction

Pairing creative solutions with complex commercial disputes may seem impractical. One may believe big companies like British American Tobacco ("BAT") would feel more comfortable sticking to a regulated and uniform dispute resolution regime on which predictable outcomes can be relied to ensure accurate earning projections for company shareholders. Although predictability is desirable, so is maximization of one's fiduciary obligations. Creative dispute resolution tailored to the case at hand ultimately saves company time and resources, thereby maximizing shareholder profits. To illustrate this, we look at a disagreement between BAT and Pall Mall Export Clothing ("PMEC"), a popular Netherlands clothing company, over brand valuation.[2]

PMEC sells trendy casual clothing, originally modeled after 1950s aviation gear. The brands that make up their successful clothing collection were previously owned by BAT – the vestige of an outdated business model. A few years ago, Michael Leathes, then head of intellectual property at BAT, was trying to narrow BAT's focus to the tobacco industry, and Bob Bulder, the managing director of PMEC, decided he would feel more comfortable owning rather than licensing the brands. A sale of the brands was complementary to both companies' interests. However, when it came to price, both sides arrived at drastically different numbers. PMEC was willing to pay for the brands but did not feel they commanded the price tag BAT had proposed.

Both sides realized that this disagreement needed to be addressed quickly and cost-efficiently and that some

form of ADR would be best. Many ADR options were considered and discarded. Both sides were concerned that traditional arbitration would lead to unacceptable results (too high or too low). Baseball arbitration was also considered – a process in which best offers are written down and the arbitrator chooses the one he or she deems most just. This encourages each side to put forth its most reasonable offer. Though possibly workable, the decision in this type of arbitration was deemed too one-dimensional, perhaps missing the potential for creative business solutions. Mediation was also considered, but the fear that a timely agreement would not be reached was prohibitive. Finally, the parties decided to conduct an arbitration-mediation, in which the neutral would sit as an arbitrator in the morning and place a binding decision in an envelope on the table over lunch. The afternoon would then be spent mediating the dispute. This solution allowed for the possibility of an autonomous, multi-dimensional party-crafted solution through mediation, but also the guarantee of a resolution should the mediation fail.

After careful selection of a neutral, with help from ACBMediation, a Dutch ADR institute, the parties engaged in the arb-med. The afternoon negotiations were conducted with the ominous presence of the decision envelope from the morning hearing on the table, and yet an amicable solution was eventually reached by the parties through mediation. Though both sides were curious as to the decision, they agreed not to open the envelope. Leathes explained, "We had shaken hands. Both of us were happy with the outcome. If we opened the envelope, that situation would most likely change. One of us would suddenly have become unhappy. If the number in the envelope was higher than what we had agreed, then obviously I would be unhappy. If the number was lower, Bob would have been unhappy." The mediator, Willem Kervers, confirmed that the deal was enhanced by not opening the envelope. He explained that comparing the negotiated deal to the arbitral decision was the wrong approach. Instead, he said, "It was a multifaceted deal and they worked it out together. It was much better for them than whatever one-dimension number I had written in the envelope. This deal pleased them both. Outcomes don't come better than that."[3]

This scenario highlights the well-known benefits of ADR: (i) party control or choice; (ii) efficiency; (iii) privacy; (iv) cost reduction; (v) flexibility; and (vi) preservation of relationships. It also demonstrates that ADR processes cannot be viewed in isolation and instead need to be viewed within the larger ADR context. The parties understood the benefits and drawbacks of various different approaches and were free to combine techniques and processes into a single, efficient, fair process that, most significantly, met their business needs. The fact that they both felt the deal preserved their relationship cannot be understated. It would be difficult or impossible to craft regulation permitting this high level of creativity and customization.

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Effectiveness of Self-Policing

A common argument against regulation is one that uses "free market" theories to reason that if the ADR industry is unfettered by regulation, competition will inspire effective self-policing. Parties will seek institutional ADR providers with unbiased neutrals who can deliver high-caliber services.[4] It has been our experience that stiff competition and service provider initiatives have provided sufficient self-policing in the business-to-business context. It also has been our experience, as demonstrated by the BAT-PMEC deal, that differently situated commercial parties will not hesitate to adjust their methods to create hybrid processes that institutionalized settings cannot provide. This is more than ADR as a better way – it's a market accommodation that accelerates the move to interest-based bargaining and brings efficiency that is not only in the parties' interests but in society's as well.


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Some initiatives by the International Institute for Conflict Prevention and Resolution ("CPR Institute"), which both authors are affiliated with, exemplify this rationale.[5] The CPR Institute's approach uses its committees to develop guidelines and protocols in lieu of inflexible requirements. A recent example is the CPR Guidelines for Early Disposition of Issues in Arbitration.[6] These guidelines set out the types of issues for which early disposition may be appropriate and suggest ways they may be addressed and responded to – always providing that early disposition will result in overall efficiencies. The guidelines include cost-shifting potential if parties make premature or meritless requests.

An example of a more proscriptive approach by CPR is the CPR-Georgetown Commission on Ethics and Standards of Practice in ADR, which promulgated several groundbreaking documents, including a set of Provider Principles for organizations involved in ADR. The impact of the CPR-Georgetown Commission in this area has been tangible; for example, all members of CPR's Panels of Distinguished Neutrals are required to adhere to the Commission's Model Rule for The Lawyer as Third-Party Neutral.

In addition to this commission, CPR also created the CPR Commission on the Future of Arbitration in 1998 to provide educational guidance for users of business-to-business arbitration. Among the bedrock principles emerging from the commission's work is the idea that arbitrators should be impartial and independent and preside over a process that ensures all parties' due process rights are fully protected. CPR has always required under its Arbitration Rules that all arbitrators be "independent and impartial" and that awards issued by arbitrators contain a reasoned explanation.[7] CPR has never endorsed the notion of a partisan party-appointed arbitrator and has always objected to any deviation from a fair, impartial arbitration process.

CPR is not alone among ADR institutions that are able to effectively self-police. In 1998, the American Arbitration Association promulgated the Consumer Due Process Protocol. This protocol has been widely disseminated, has enjoyed judicial support and has been cited more than 140 times in journal and law review articles.[8] These principles focus on unbiased administration, equal voices among parties with unequal bargaining power in neutral selection, preservation of court relief, reasonable cost to the consumer and the accessibility to court remedies in the arbitration. These tangible examples of self-regulation illustrate the drive of the ADR industry to establish boundaries for itself that command fairness and integrity.

Damage to Party Autonomy and Flexibility

At the heart of ADR lies contract law, which is constitutionally recognized and the reason ADR is able to function in our legal system. The policy behind the freedom of contract is founded on, among other things, the importance our society places on autonomy. Government regulation of ADR means there would be an external force dictating terms that may or may not be relevant to the particular circumstances. The strength of the agreement would automatically be diminished because ownership and commitment to the ADR agreement would no longer lie with the individual parties.

A regulated approach to ADR could produce a restrictive default ADR model that could soon become the norm. That's not the reality of the BAT-PMEC transaction described above, nor is it the way ADR is used by businesses. Regulation typically proscribes standards of practice, and conformity to such practices is encouraged or mandated. This one-size-fits-all method would strip creativity and the drive to create a better and more effective dispute resolution system. It's a path that court ADR programs have sought to avoid.

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In the introductory example, if the parties had been forced to use a standard mediation or arbitration process or select a neutral from a prescribed court list, they may not have had the confidence in the process or the neutral, which could have reduced their chances for having a positive experience. Indeed, as shown by a 2011 survey of Fortune 1000 companies, businesses choose ADR over litigation because they wish to have more control over the design of the process and improve their results while still preserving relationships.[9] If an ADR process cannot provide those perceived benefits over a standard litigation process, business simply will not use it.

Limited regulation, in the area of private dispute resolution, is possible because of the wide range of tools to assist in the management of conflict, including published guidelines and rules for the resolution of conflict. The implementation of a tailored, efficient and effective process should not need to first be checked against bureaucratic regulations that block deployment, development and advancement.

Potential for Unintended Consequences

If ADR regulations are considered for matters outside the commercial context, we strongly advocate for caution in drafting and for allowing flexible ADR provisions. We have seen this unfortunate event in the early proposed drafts to amend the Federal Arbitration Act to protect

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"consumers" from arbitration. The definitions used initially were imprecise and far-reaching. They inadvertently invalidated pre-dispute agreements to arbitrate commercial disputes, including potential impact on international, as well as domestic arbitration.[10] Therefore, provision must be made in any regulation to allow the parties to tailor the process for their particular situation. In this way, some of the autonomy may be retained in ADR.

Even when allowing for flexibility, regulators must still proceed with prudence in order to avoid possible unintended consequences. Situations that must be considered before regulation is passed include: (i) the more regulated ADR becomes, the more the courts will be forced to deal with cases interpreting the regulations; (ii) regulation efforts and enforcement will deplete government resources that may be best allocated elsewhere; (iii) state licensing of arbitrators and mediators puts geographic limits on what was traditionally a multi-jurisdictional/cultural practice; and (iv) creating barriers to the practice of ADR would hinder those practitioners who provide low-profit services. These, and other possible effects of regulation, must be thoughtfully considered before proceeding with regulation, which may prove difficult given the increasing polarization of lawmaking in this country.

Conclusion

There is no doubt that those who want ADR regulations do so from the well-meaning position of wanting to improve the process. But the best of intentions may have adverse effects. The field of commercial ADR itself exemplifies how private processes inspire self-policing of creative and individually-suitable processes that have the full commitment of parties because it is their choice to engage in them. This, in turn, leads to parties' exploration of paths to efficient resolution that meet and satisfy their operational needs – in terms of dealing with their adversary, crafting terms to foster a relationship and building stronger and more lasting resolutions. The end results are agreements that, one-by-one, help reduce the conflict in our society in an effective, efficient and private manner that preserves both personal and business relationships. ADR regulation in certain areas of law may be beneficial, but rules must be drafted with the utmost care while taking into consideration all angles of the debate. ◆

Endnotes

1 The authors recognize that alternative dispute resolution (ADR) combines very different processes and thus, arbitration and mediation, as well as other forms of ADR, may demand different regulatory approaches. In non-commercial contexts cautious and carefully tailored regulation of adhesion contracts, such as pre-dispute binding employment and consumer arbitration, may be appropriate.

2 Bob Bulder et al., *Einstein's Lessons in Mediation*, Managing Intell. Prop., July/Aug. 2006, at 23, *available at* http://imimediation.org/cache/downloads/8rku9n7924g00co4ksckk4ssw/einsteins-lessons-in-mediation--article-.pdf.

3 *Id.*

4 Diane Levin, *Public Licensing and Regulation of Mediators: The Arguments For and Against* (Oct. 18, 2009), http://mediationchannel.com/2009/10/18/public-licensing-and-regulation-of-mediators-the-arguments-for-and-against/.

5 Since its inception in 1979, CPR's membership has included general counsels and senior lawyers of Fortune 1000 organizations, partners of hundreds of well-respected law firms, sitting and retired judges, government officials and leading academics.

6 Available at http://www.cpradr.org/Resources/ALLCPRArticles/tabid/265/ID/744/CPR-Guidelines-on-Early-Disposition-of-Issues-in-Arbitration.aspx.

7 *See* Commercial Arbitration at its Best: Successful Strategies for Business Users (Thomas J. Stipanowich & Peter H. Kaskell, eds. 2011); CPR Rule7.1, *available at* http://www.cpradr.org/Resources/ALLCPRArticles/tabid/265/ID/600/2007-CPR-Rules-for-Non-Administered-Arbitration.aspx.

8 The protocol is available at http://www.adr.org/sp.asp?id=22019; Statistics are as of October 2010. Consumer Debt Collection, Due Process Protocol Statement of Principles 1 n.2 (Oct. 2010), *available at* http://www.adr.org/aaa/ShowProperty?nodeId=%2FUCM%2FADRSTG_003865&revision=latestreleased.

9 The 2011 Fortune 1000 Survey was conducted by the Scheinman Institute on Conflict Resolution at Cornell University, the Straus Institute for Dispute Resolution at Pepperdine University School of Law and the International Institute for Conflict Prevention & Resolution.

10 Russ Bleemer, *Congressional Arbitration Reform Returns-But It's Not Moving Soon*, 29 Alternatives to the High Cost of Litig. 139 (2011); Donald R. Philbin, *Thankful for Unanswered Prayers? Unconscionability Equilibrium*, 27 Alternatives to the High Cost of Litig. 145 (2009) (quoting Edna Sussman, *The Unintended Consequences of the Proposed Arbitration Fairness Act*, The Fed. Law., May 2009, at 48).