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BRIEFING

MEDIATION FOR COMMERCIAL CONTRACT DISPUTES

EXECUTIVE SUMMARY

1. Mediation is a method of dispute resolution within an overall category termed “**alternative dispute resolution**” or “**ADR**”. A hallmark of mediation is that it is entered into voluntarily by the parties in dispute who engage a third party (a mediator) to facilitate its resolution. It is in essence a facilitated negotiation. Lateral thinking to achieve innovative solutions comes into its own in mediation.

2. This Briefing focuses on: -

- Other types of dispute resolution;
- Key features of mediation;
- Disputes suitable for mediation;
- Drivers behind mediation;
- Mediation clauses in contracts;
- Guidance on when mediation can be rejected;
- The uncertainties / limitations of other methods of dispute resolution;
- Merits of mediation;

- Minimum requirements to make mediation work;
- The mediation process;
- Costs involved in mediation;
- Experience of the Legal Services Office;
- What is the psychology of Mediations;
- CEDR.

3. The Briefing also highlights the importance of giving full consideration to mediation at all stages of a dispute.

“It is madness to incur the considerable expense of litigation in England usually disproportionate to the amount at stake without a determined attempt to reach an amicable settlement. The idea that there is only one just result of every dispute, which only the court can deliver is, I believe often illusory. Litigation has a cost, not only for the litigants but for society, because judicial resources are limited and their cost is usually born - at least in part - by the state. Parties should be given strong encouragement to attempt mediation before resorting to litigation, there should be built

into the process a stage at which the court can require them to attempt mediation - perhaps with the assistance of a mediator supplied by the court.”¹

OTHER TYPES OF DISPUTE RESOLUTION?

4. The more frequently used forms of dispute resolution are: -
 - Litigation;
 - Arbitration;
 - Adjudication;
 - Expert determination; and
 - Negotiation.
5. Flexible consideration needs to be given at the outset of a contract as to which options are to be set out in the contract. Equally once a dispute has arisen further consideration needs to be given as to which option is to be operated and that may change during the course of a dispute. For instance, it is not unusual for a dispute to start by reference to arbitration and such arbitration to result in a solution by mediation.

KEY FEATURES OF MEDIATION?

6. The distinctive features are that: -
 - It is a voluntary process entered into by the parties in dispute;
 - The mediator is independent of the parties;

¹ Speech by Lord Phillips of Worth Matravers Lord Chief Justice of England and Wales - Alternative Dispute Resolution: An English Viewpoint - 29 March 2008.

- The mediator facilitates resolution by meeting with the parties individually;
- The mediator facilitates the reaching of a consensus but does not impose a view / judgement;
- The mediator is funded by the parties;
- The scope of the mediation can be widened to include matters not comprised in the initial dispute. It can therefore be used to: -
 - Set a framework for future working between the parties in dispute;
 - Provide for an apology to be given;
- The mediation and any settlement agreement reached are confidential.

WHICH DISPUTES ARE SUITABLE FOR MEDIATION?

7. Mediation may be suitable for most types of disputes, and in particular those where: -
 - It is important to maintain a good working relationship between the parties (e.g. in a long term partnering contract) which could be jeopardised by a protracted dispute;
 - Negotiation has been attempted but has failed (particularly where there is a single / substantial point in issue which neither party appears able to give ground on);

- The cost and time of other methods of dispute resolution are uneconomic.

8. Mediation may be an inappropriate method of dispute resolution where: -

- A binding precedent is required e.g. by securing a declaration of the rights of a particular party;
- Immediate relief is necessary e.g. through the granting of an injunction.

DRIVERS BEHIND MEDIATION?

Court Procedure

9. A revised version of the Construction and Engineering Pre-action Protocol was introduced on 6 April 2007.

“In respect of each agreed issue or dispute as a whole the parties should consider whether some form of alternative dispute resolution would be more suitable than litigation and, if so, endeavour to agree which form to adopt. It is expressly recognised that no party can or should be forced to enter into any form of alternative dispute resolution.” [Paragraph 5.4].

10. The Civil Procedure Rules 1998 (“**CPR**”) set out a number of overriding objectives to enable courts to deal with cases justly.

11. Rule 1.4 (2) requires that the court must further the overriding objective by actively managing cases which includes: -

“(e) Encouraging the parties to use an alternative dispute resolution procedure if the

court considers that appropriate and facilitating the use of such procedure.”

12. Rule 26.4 (1) provides that: -

“A party may, when filing the completed application questionnaire, make a written request for the proceedings to be stayed while the parties try to settle the case by alternative dispute resolution or other means.”

13. The Practice Direction on Pre-Action Conduct provides the following guidance:-

- The aims of the Practice Direction are to be achieved by encouraging the parties to consider using a form of Alternative Dispute Resolution (“ADR”) (Paragraph 1.2(2).)
- The court may decide that there has been a failure of compliance by a party because, for example, that party has unreasonably refused to consider ADR. (Paragraph 4.4(3).)
- “Starting proceedings should usually be a step of last resort, and proceedings should not normally be started when a settlement is still being actively explored. Although ADR is not compulsory, the parties should consider whether some form of ADR procedure might enable them to settle the matter without starting proceedings. The court may require evidence that the parties considered some form of ADR.” (Paragraph 8.1.)
- “The parties should continue to consider the possibility of

decision to close the home. The court held that: -

“The parties do not today under the CPR, have a right to have a resolution of their respective contentions by judicial review in the absence of an alternative procedure which would cover exactly the same ground as judicial review. The courts should not permit, except for good reason, proceedings for judicial review to proceed if a significant part of the issues between the parties could be resolved outside the litigation process.”

Best Value Duty

14. Local authorities have a best value duty under Section 3 Local Government Act 1999. This is a duty to make arrangements to secure continuous improvement in the way in which their functions are exercised, having regard to a combination of economy, efficiency and effectiveness. Mediation may often achieve the 3Es: -

- **Economy** – mediation will usually be significantly less costly than other forms of dispute resolution.
- **Efficiency** – mediation will equally deliver an outcome with far less pre-hearing work and preparation and a significantly shorter hearing.
- **Effectiveness** – finally, mediation will produce a solution which both parties have signed up to and therefore can support, not an outcome that has been imposed by a third party.

Judicial Warning

15. In **Frank Cowl –v- Plymouth City Council** (2001) the Court of Appeal considered an appeal relating to an application for judicial review by a number of claimants who lived in a residential care home owned and run by Plymouth City Council. The claimants sought judicial review of the local authority's

16. In addition there was a key message to lawyers to properly consider dispute resolution as the court emphasised: -

“This case will have served some purpose if it makes it clear that lawyers acting on both sides of a dispute of this sort are under a heavy obligation to resort to litigation only if it is really unavoidable.”

Costs Risk

17. The case of **Dunnett –v- Railtrack plc** (2002) demonstrated the costs risk involved in rejecting ADR.² Ms Dunnett appealed against a County Court decision which dismissed her claim in negligence against Railtrack plc arising from the death of her horses on a railway line. Railtrack had rejected the suggestion of ADR made by the court when Ms Dunnett was granted permission to appeal. Whilst Railtrack were successful in the appeal to the

² This is relevant when a court exercises its discretion as to costs by reference to the conduct of the parties under Rule 44.3 (5) (a) CPR.

Court of Appeal it was not awarded costs as it had refused ADR. Railtrack's approach was that it considered that ADR would necessarily involve payment of sums over any offer already made to the claimant.

18. The Court of Appeal ruled that this was a misunderstanding of the purpose of ADR. The court stressed to lawyers the duty to further the overriding objective and to the possibility that if a party turned down ADR out of hand when suggested by the court such refusal could have uncomfortable consequences in costs.

ARE MEDIATION CLAUSES ESSENTIAL IN CONTRACTS?

19. It is useful to include mediation as one of a number of possible dispute resolution clauses in any commercial contract. If such a clause is not included then it is still possible for the parties to agree to mediate a dispute. However a suitable clause: -

- gives more weight to invoking mediation;
- will identify a particular procedure; and
- may compel a party rejecting mediation to explain their reason for so doing
- may preclude another method of dispute resolution being engaged when mediation has not been tried.

20. The Legal Services Office have produced a number of dispute resolution procedures ("**DRPs**"), including: -

- A DRP with a range of solutions including mediation;
- The City Council's Adjudication Scheme .

21. HM Treasury has produced guidance on key issues that arise in PFI projects in order to promote the achievement of commercially balanced contracts, and enable public sector procurers to meet their requirements and deliver best value for money. The fourth edition of the Standardisation of PFI Contracts ("**SOPC4**") was published by HM Treasury in March 2007. SOPC4 is mandatory for all PFI Projects that are still in competitive procurement (i.e. where final bids have not yet been received or are competitive dialogue has not yet been closed on or after 1 May 2007). If a procuring body considers that it is impossible to amend an individual contract so that it is compliant with SOPC4 it will need specific approval for its approach from HM Treasury ("**a derogation**"). Projects which are not compliant with SOPC4 and have not had their derogations approved by HM Treasury will not have the Final Business Case (FBCs) of their projects approved. In the case of local authority PFI projects, SOPC4 compliance is a pre-requisite for approval of projects by the Project Renew Group.

22. The form of dispute resolution in SOPC4, Section 28, comprises a three stage process of consultation, adjudication and arbitration. SOPC4 recognises that the parties may wish to incorporate some form of Alternative Dispute Resolution. If this is the case than Government

decisive, and this is not an exhaustive check-list: -

23. The Centre for Effective Dispute Resolution (“CEDR”) has produced a dispute resolution procedure for PFI and long term contracts.
24. In the case of **Cable & Wireless plc -v- IBM United Kingdom Ltd** (2002) the High Court considered a contract which required that if a matter is not resolved through negotiation the parties would attempt in good faith to resolve it through an ADR procedure as recommended to the parties by CEDR. Cable & Wireless sought a declaration that this ADR clause was nothing more than agreement to negotiate and therefore unenforceable. IBM made a cross-application to court that proceedings should be stayed pending the referral of the dispute to ADR. The court considered that there was a mutual intention to have the issue finally decided by the courts only if ADR did not resolve the matter. There was a reference to a defined procedure in the dispute resolution clause. Consequently the proceedings would be stayed to allow ADR to take place.

WHEN CAN MEDIATION BE REJECTED?

25. The Court of Appeal in **Halsey – v- Milton Keynes General NHS Trust** (2004) considered factors that may be relevant on the question as to whether a party has unreasonably refused ADR³. No single factor was considered

³ The principles in Halsey were applied in the case of Burchell –v- Bullard (2005) CA.

- **The nature of the dispute** – some disputes are intrinsically unsuitable for ADR. This would include where the parties wish the court to determine issues of law or construction which may be essential to the future trading relations of the parties as under an on-going long-term contract. Alternatively, a party wishes to have a point of law resolved.

- **The merits of the case** – if a party reasonably believes it has a strong case this is relevant to the question of whether it has acted reasonably in refusing ADR. Large organisations, especially public bodies, are vulnerable to pressure from claimants who, having weak cases, invite mediation as a tactical ploy. In contrast, borderline cases are likely to be suitable for ADR unless there are significant counterrailing factors.

*“The fact that a party **unreasonably** believes that his case is watertight is no justification for refusing mediation. But the fact that a party **reasonably** believes that he has a watertight case may well be a significant justification for a refusal to mediate.”*

- **Other settlement methods have been attempted** – mediation often succeeds where previous attempts have failed.

- **The costs of mediation would be disproportionately high** – this is a factor of particular importance where, on a realistic assessment, the sums at stake in the litigation are comparatively small.
- **Delay** – if mediation is suggested late in the day, acceptance of it may have the effect of delaying the trial of the action.
- **Whether the mediation had a reasonable prospect of success.**

26. The fundamental question is whether it has been shown by the unsuccessful party that the successful party **unreasonably** refused to agree to mediation. Where a successful party refuses to agree to ADR despite the court's encouragement, that is a factor which the court will take into account when deciding whether his refusal was unreasonable. The stronger the court's encouragement, the easier it will be for the unsuccessful party to discharge the burden of showing that the successful party's refusal was unreasonable.

WHAT ARE THE UNCERTAINTIES / LIMITATIONS OF OTHER METHODS OF DISPUTE RESOLUTION?

27. It may be incorrectly concluded that mediation means sacrificing the ability to get to the truth of the matter which would otherwise be achieved by a day in court. In practice, mediation will comprise a robust and structured negotiation.

28. There is no 100% certainty in the outcome of any dispute resolution process. In particular: -

- A judge / arbitrator / adjudicator may reach a decision which is unexpected by the parties or may not provide an analysed judgement so that it is difficult to determine how the conclusion was reached other than that the evidence of a particular witness was preferred;
- A key witness may not come up to proof;
- Evidence may emerge late which is fatal to a party's case;
- In the event a party is successful it will not recover its clients' costs and it will be unlikely to recover more than 75% of its legal costs.

29. Many disputes settle either before or early on after the start of the final hearing. In such cases the question has to be asked as to whether significant costs could have been saved had the process to negotiate a solution been embarked upon earlier.

30. It is not unusual for the costs in litigation to dwarf the sums in issue.⁴

MERITS OF MEDIATION

31. Mediation often provides a best value solution as: -

⁴ In *Burchell –v- Bullard* (2005) the court described as "horrific" a judgement of £5K procured at a cost to the parties of £185K. It also described as "kitchen sink litigation" where a £100K counterclaim succeeded in the sum of only £14K.

- **Costs are minimal** compared with most other methods of dispute resolution, particularly litigation and arbitration;
- Mediation should produce an **outcome within 3 months** of a referral which again is faster than most arbitration and litigation although not as quick as adjudication;
- The time spent at the **mediation hearing of a day or possibly 2 days** is time well spent compared to the time that could be incurred in a final hearing in litigation / arbitration;
- Mediation has a **very high success rate**. Whilst varying statistics are produced with different types of mediation the general perception is that well over two thirds of all references to mediation are successful. This may be on account of the psychology of the process as the parties should go into the mediation with the aim of achieving a satisfactory outcome;
- The outcome of the mediation is usually **confidential**;
- Mediation, like good negotiation, is intended to provide a **win:win solution**. It can restore a working relationship. It is not axiomatic that there has to be pain on both parties in a mediation for a deal to be struck.
- *“Skilled mediators are now able to achieve results satisfactory to both parties in many cases which are quite*

beyond the power of lawyers and courts to achieve.”⁵

- *“The mediation process itself can and often does bring about a **more sensible and conciliatory attitude** on the part of the parties than might otherwise be expected to prevail before the mediation, and may produce a recognition of the strengths and weaknesses by each party of his own case and that of his opponent, and a willingness to accept the give and take essential to a successful mediation.”⁶*

MINIMUM REQUIREMENTS TO MAKE MEDIATION WORK

32. ADR should not generally be attempted until a party has ascertained the strengths and weaknesses of both its and its opponent’s case. A reference to mediation does not exonerate a party from putting together a detailed assessment of the matter (“**Commercial Analysis**”). This is likely to be in a spreadsheet format and will breakdown the claim (and any counterclaim) into its component item with:-
- An assessment of the strength and weaknesses of each item;
 - What (if anything) has been allowed in respect of the item in any offer made;
 - The likelihood of success on each item;
 - The likely outcomes if the matter proceeded to a hearing on different bases -

⁵ Brooke LJ in **Dunnett –v- Railtrack**.

⁶ **Hurst –v- Leeming** (2001).

ie a favourable outcome, an unfavourable outcome

- Costs, fees and payments made to date;

as well as:-

- Costs of the mediation;
- Likely costs to be incurred if the matter proceeds to a full hearing;
- Significant evidential or other commercial issues that may impact upon the dispute; and
- Non pecuniary benefits that can be put forward by either party in reaching a settlement.

33. As with any form of dispute resolution where the third party can be chosen e.g. adjudicator / arbitrator / mediator it is essential to select a mediator who has the skills training and expertise to undertake this role whom the appointing person has confidence in. It will be necessary to agree the mediator with the other side.

34. It is also essential that both parties have a lead negotiator who has full authority to settle the outcome of the mediation without reference back to a board of directors or a Cabinet / Cabinet Member / Cabinet Committee to "ratify" or authorise the outcome. Signing off an agreement is very much part of the mediation process.

35. A small but effective team needs to be put together to act at the mediation. This will comprise: -

- Usually a lawyer whose role will be to present the party's case in summary at the plenary session at the start of the mediation. The lawyer should have produced the Commercial Analysis. The lawyer will also be there to assist the drafting of any agreement reached at the end.
- The key player is the lead client negotiator. It is essential that they are able to take a commercial view of the dispute and able to negotiate it to a satisfactory outcome. The negotiator needs to be of sufficient authority in order to justify their decision to any members or officers who may subsequently scrutinise their decision. It is best that they have not had any day to day involvement in the issue the subject of the dispute previously.
- Finally, it is essential that the officer who has had day to day conduct of the dispute and therefore has a full technical understanding of the strengths and weaknesses of the issues, together with the background documentation is present.

MEDIATION PROCESS

36. At the outset it is necessary to agree who is to be appointed as mediator and to agree the terms of their appointment. This will provide for each party to pay their share of his fees (50% in a 2 party mediation).

37. Once a mediator has been appointed they will set out a set of directions / framework for the

38. Next it is necessary to agree both a time and venue for the mediation hearing. A mediation is best undertaken at a neutral venue. There should be a minimum of an uninterrupted 8 hour day allowed for the mediation. Whilst this may seem excessive, mediation can be a slow process and an adjournment at the end of a hearing which has proved too short should be avoided.
39. At the outset of the mediation hearing the mediator will invite both parties at a plenary session to present orally a brief of their respective positions. This is an opportunity for both parties to express sincerely their wish to reach a solution and to acknowledge issues that are not disputed. The mediator will then allow both parties an opportunity to ask brief questions and that the mediator may also put a series of questions. At this point the parties then return to their respective syndicate rooms. The mediator will then meet with the parties separately and engage in a process of dialogue in order to bring the parties to an agreement.
40. The mediator will start off this facilitation process by getting to understand in more detail the strengths and weaknesses of each party's case. The mediator may also invite the parties' lawyers to meet with him (but without other members of their teams) or alternatively just their technical experts in order to clarify issues or to test the strength of a party's case. It may therefore be well into the afternoon before the first offer is made in the mediation.
41. It is important to note that the mediator is not mandated to reach any decision and whilst he/she may make an observation to a party in their syndicate discussions about an issue in that party's case, the mediator's role is to facilitate the reaching of an agreement.
42. A mediator will not disclose confidential information which has been communicated to the mediator without that party's prior consent. The mediator will be scrupulously careful to ensure that before leaving a syndicate briefing with one party that that party consents to any disclosure the mediator proposes to make.
43. The mediator may of their own volition put forward suggested solutions or give the parties exercises to work on in order to bring them to a consensus. A skilled mediator can "oil the wheels of settlement" in ways that are likely to be more-effective than the normal process of negotiation by discussion and offer and counter – offer.⁷

⁷ Hickman-v- Blake Laphorn (2006) EWHC 12 QB unreported.

44. It is not unusual for the parties to experience some despair during the day that a deal will not be struck as the parties appear far apart. This may be evident if the opening offer made by one party is unrealistic. It is essential for parties to persist in trying to reach an accommodation.
45. Once an effective offer is made following a correspondingly dynamic counter offer, the "bidding process" will move progressively faster provided that the parties do not adopt a salami approach in bridging the gap.
46. Once agreement is reached then the mediator will bring the parties back together for a final plenary session at which the final agreement between the parties will be documented and signed off by the lead negotiators for both parties.
47. It is important to fully appreciate the confidentiality of any agreement that is reached. A significant negotiating point for a party may well be that the outcome of any agreement remains confidential. If an agreement is confidential then any disclosure within either party's organisation must necessarily be strictly limited to avoid any fresh action on the basis of a breach of confidentiality since this might result in a significantly higher value claim than that which was the subject of the original mediation.
48. Each party can agree to pay their own costs or agree that the documented agreement at the conclusion makes reference to what proportion (if any) is paid by each party. The costs comprise:-
- Mediator's fees;
 - Legal costs; and
 - Accommodation costs.
49. Mediators will often have a scale of fees which are directly related to the value of the claim. They will have a fee per party per mediation day as well as a fee per party preparation time. It is therefore possible to predict with a fair degree of certainty what a mediator's fees will be at the outset on the assumption that the mediation lasts the time allotted.
50. The parties will need to pay their own lawyers' fees. However it is unusual to have more than one lawyer per party or to engage counsel. Since the documentation is quite limited compared with litigation, arbitration or adjudication the lawyer time spent in preparing documentation should be minimal.
51. There will also be accommodation fees for a neutral hearing. This hearing should be at a place which is convenient for both parties and the mediator. It is essential to have both a sufficiently large meeting room at which both parties' teams and the mediator can be present for the plenary sessions as well as having two separate syndicate rooms where each party's team will spend the rest of the time when not in a plenary session. The accommodation therefore needs to be reasonably comfortable and to have sufficient working space.

COSTS INVOLVED IN MEDIATION

48. Each party can agree to pay their own costs or agree that the documented agreement at the conclusion makes reference to

EXPERIENCE OF LEGAL SERVICES OFFICE IN MEDIATION

52 The Procurement Team has undertaken mediation work for the Council both as claimant and as respondent and both in two and three party mediations. In three of the mediations conducted to date the sums in issue exceeded £1m. This has included a claim where the other party was legally aided. 80% of the mediations reached a successful outcome although more often than not they overran their initial allotted time. Confidentiality precludes any further details being given.

PSYCHOLOGY OF MEDIATIONS

53. Litigation and arbitration are essential adversarial processes, and the experience of Legal Services in commercial arbitration is that the party usually succeeds with respect to the greater part of their claim/defence; there are no "score draws". For most advocates the experience of success following a protracted heavy weight hearing is memorable.

54. Equally many lawyers experience great satisfaction in closing a deal over which they have negotiated hard and which satisfies their clients. The distinction from the adversarial process is that they have had control over the outcome (assuming of course that the client has accepted the advice on closure). Signing off a settlement agreement in that respect has similarities with attending a completion on a major deal. A key part of the process is shaking hands in sincerity with the person who was previously your adversary but has

been working with you to reach a solution you can both live with.

CEDR

55. CEDR is the Centre for Effective Dispute Resolution. Its head office is at the International Dispute Resolution Centre, 70 Fleet Street, London EC4Y 1EU, e-mail infor@cedr.com. CEDR's web site provides the following information about itself:-

- Launched in 1990 with the support of the Confederation of British Industry (CBI) and leading law firms, business and public sector;
- Over 20 years unrivalled experience in dispute resolution, conflict management, training and civil justice systems;
- It is independent and neutral;
- It is committed to cutting the cost of conflict and creating a world of choice in conflict prevention and resolution;
- It is supported by members including multinational organisations, international law firms and professional and governmental bodies;
- It has been instrumental in bringing mediation into business practice and into the judicial system in England and Wales, and in creating a professional approach in commercial mediation in the UK and internationally.

CEDR's services:-

- CEDR Solve is the leading commercial ADR provider in Europe and one of the largest and leading ADR organisations internationally.
- It is an impartial and credible third party used to facilitate negotiations in complex and sensitive multi-party conflict and dialogue.
- It is the premier trainer of mediators worldwide offering internationally recognised accreditation.
- It equips business people and professionals with the practical skills needed to apply proactive and positive approaches to conflict management throughout their work.
- It provides consultancy services to business, law firms and public sector organisations to develop their conflict management capabilities.
- Leading companies, governments and public-sector organisations use its expertise to devise schemes and procedures to manage all kinds of conflict, within the organisation or externally, with customers, partners and other stakeholders.
- It works with governments on court-based initiatives in the UK and world-wide.

Legal Service has previously used mediators provided by CEDR and has conducted a mediation at CEDR's office in London

Conclusion

56. The key question to ask is why you are not using mediation to solve disputes. If you do not have intractable issues and always secure the outcomes you wish to achieve then ADR may not be for you.
57. If parties have set aside a number of days for a hearing in an arbitration it is likely that one of them has made a significant error in the strength of their case and/or the opponents case.
58. Weight has to be given to the statement made as recently as April 2005 that: -

*"Halsey has made plain not only the high rate of a successful outcome being achieved by mediation but also its established importance as a track to a just result running parallel with that of the court system. Both have a proper part to play in the administration of justice. The court has given its stamp of approval to mediation and it is now the legal professional which must become fully aware and acknowledge its value. The professional can no longer with impunity shrug aside reasonable requests to mediate."*⁸

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⁸ Judgement of LJ Rix in Burchell –v- Bullard (2005) CA.