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ALTERNATIVE DISPUTE RESOLUTION

“WHY IT WORKS AND WHY IT DOES NOT”

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ALTERNATIVE DISPUTE RESOLUTION: WHY IT DOESN'T WORK AND WHY IT DOES

Back in the 1980s, experts and executives alike heralded alternative dispute resolution (ADR) as a sensible, cost-effective way to keep corporations out of court and away from the kind of litigation that devastates winners almost as much as losers. Over the next few years, more than 600 large corporations adopted the ADR policy statement suggested by the Center for Public Resources, and many of these companies reported considerable savings in time and money.

But the great hopes for ADR faded quickly. Damage awards, legal billings, and the number of lawsuits in the United States continued to rise—even for many of the companies that had embraced ADR. In fact, one study found that rather than reducing costs and delays, at least one form of ADR—court-annexed arbitration—had actually increased them.

What had gone wrong? Was ADR really just an empty promise? We believed it was not, but lack of success with ADR at so many companies prompted us to take a closer look at how managers were implementing the ADR process.

We found bad news and good. The bad news is that ADR as currently practiced too often mutates into a private judicial system that looks and costs like the litigation it's supposed to prevent. At many companies, ADR procedures now typically include a lot of excess baggage in the form of motions, briefs, discovery, depositions, judges, lawyers, court reporters, expert witnesses, publicity, and damage awards beyond reason (and beyond contractual limits).

The good news is that a number of companies have learned to use ADR effectively, and those companies are in fact reaping ADR's predicted benefits: lower costs, quicker dispute resolutions, and outcomes that preserve and sometimes even improve relationships. At Chevron, for instance, ADR-based mediation of one dispute cost $ 25,000, whereas mediation through outside counsel would have cost an estimated $ 700,000 and going to court as much as $ 2.5 million over a period of three to five years. At Toyota's U.S. subsidiary, a Reversal Arbitration Board, set up to ease contention between the company and its dealers concerning allocation of cars and sales credits, has brought about a steady decline in the number of these cases, from 178 cases in 1985 to 3 in 1992.

What are Chevron and Toyota doing that other companies are not? The difference between success and failure lies chiefly in the level of commitment. Companies that give ADR top priority—even in cases where they're sure they're right—are realizing immense savings of time, money, and relationships. In contrast, companies that let old litigious habits worm their way into the process might as well go back to court.

Few companies have made the commitment to ADR more effectively than NCR (recently renamed AT&T Global Information Solutions). NCR executives made a firm commitment to alternative dispute resolution a decade ago, and the results have been dramatic: the number of the company's filed lawsuits (excluding insured risks) pending in the United States dropped from 263 in March 1984 to 28 in November 1993. Last year, only nine disputes incurred outside attorneys' fees exceeding $ 20,000, and total outside legal fees—not quite $ 1 million—were less than half what they were in 1984. Moreover, the reduction in outside fees has not increased the costs of in-house counsel. NCR manages its filed cases with only four in-house lawyers and four paralegals.

Several years ago, in a case in which it did not have an arbitration clause, NCR spent hundreds of thousands of dollars defending itself in a conventional lawsuit and nevertheless lost a multimillion-dollar jury verdict. In the past five years, NCR has paid out less in awards and settlements—and in outside and in-house counsel fees for all of its ADR matters—than the outlays for that single case.

HOW ADR GOES WRONG

As we've said, to make alternative dispute resolution work, management must adopt the principle wholeheartedly. Consider the following sad but true story of two large electronics manufacturers—both, ironically, subscribers to the Center for Public Resources policy statement.

About 15 years ago, Company A, which makes computer-support products, licensed Company B to manufacture a new device. The arrangement was a means of expanding the market by offering a second source of the product. The device was wildly successful, but by the mid-1980s, Company A had developed its technology and improved the device, and it refused to let Company B manufacture the new design. Fearing it would lose a lucrative market, Company B threatened a lawsuit, and when the threat had no effect, it reverse engineered the new device and began to manufacture and market its own version. Now it was Company A's turn to threaten a suit.

Instead of litigating, however, the companies respected a clause in their contract and headed into arbitration. Under normal circumstances, arbitration might take anywhere from 6 to 12 weeks, but in this case it ballooned into a five-year marathon, with five to six hours of testimony four or five days every single week. While the proceeding followed the customary rules of arbitration—in theory, extremely limited discovery and depositions—the judge in the case skirted convention by subpoenaing evidence, so that much of the time was actually spent in discovery nevertheless. In addition, lawyers on both sides began taking depositions, though they were careful not to use that word. One observer characterized the two sides as being driven by "fierce litigiousness, arrogance, and greed," and charges of attorney misconduct flew back and forth almost daily.

Eventually, the judge ruled against Company A, which promptly asked an appeals court to overturn the decision. After that, both companies began to litigate in earnest. They are still fighting today, and the list of suits and countersuits grows longer every year. Company B is estimated to have laid out as much as $ 25 million a year to pursue its claims.

This depressing account graphically illustrates how an alternative method of dispute resolution can go wrong when the parties lack the commitment to make it work. Ingrained attitudes and belligerent corporate cultures worked against an equitable, agreeable outcome. In this case and in others we have seen, the chief obstacles were one or more of the following attitudes.

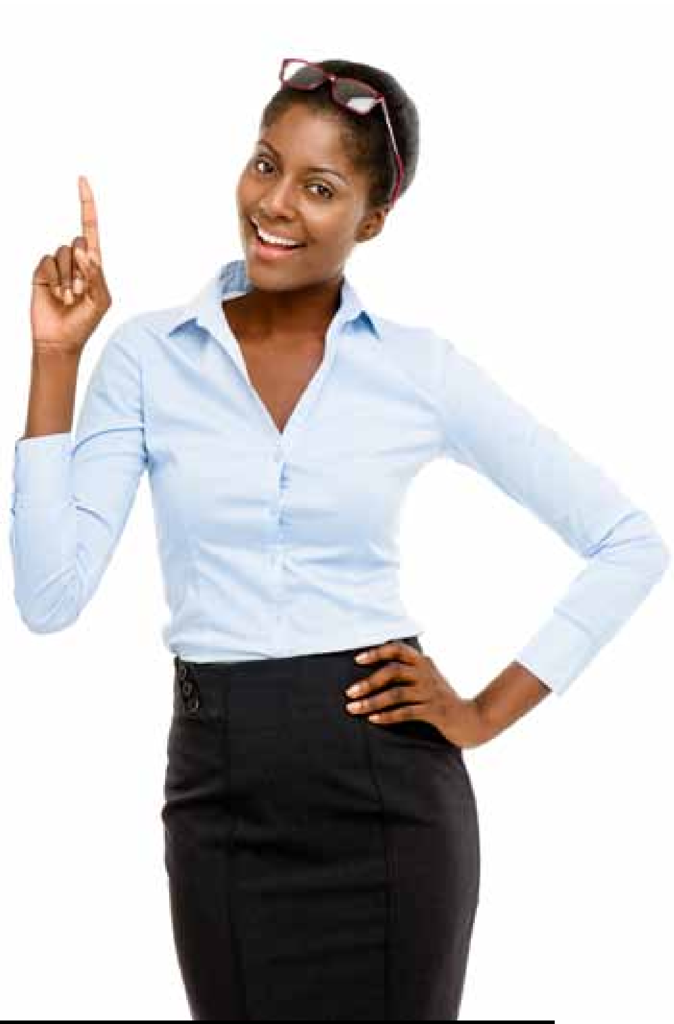
WINNING IS THE ONLY WAY

FEW SENIOR CORPORATE MANAGERS ARE WILLING TO FORGO A CHANCE TO WIN A COURTROOM TRIUMPH. HERE'S THE WAY A TOP LAWYER AT A MAJOR COMPANY PUTS IT: "CEOS WANT TO BE ABLE TO TAKE THE OTHER GUY TO THE CLEANERS IF THEY BELIEVE THEY'RE IN THE RIGHT, AND THEY'RE GOING TO BET THE RANCH IF THEY HAVE TO." OFTEN THE CASE ITSELF BECOMES LESS IMPORTANT THAN THE PRINCIPLE INVOLVED. IN THE STRUGGLE BETWEEN THE ELECTRONICS GIANTS, FOR INSTANCE, THE CHIEF LEGAL COUNSEL FOR COMPANY A DECLARED, "IF THE OTHER SIDE CONTINUES ITS STRATEGY OF COPYING, I'M GOING TO CONTINUE THIS STRATEGY OF SUING.

" IT'S ONE THING FOR THE CORPORATE GENERAL COUNSEL TO ARGUE FOR ARBITRATION WHEN HIS OR HER COMPANY IS THE RESPONDENT OR, AS IS OFTEN THE CASE, WHEN BOTH PARTIES ARE CULPABLE TO SOME DEGREE. UNDER THESE CIRCUMSTANCES, COMMON SENSE URGES NEGOTIATION TO LIMIT THE EXTENT OF THE CLAIMS. BUT WHEN THE COMPANY APPEARS TO BE IN THE RIGHT,

WHEN MILLIONS IN REVENUES ARE AT STAKE, AND WHEN DECISION MAKERS ACHE TO GO TO THE MAT TO PROVE THEIR POINT, ARGUING FOR ARBITRATION MAY STRIKE SOME AS FOOLISH, IF NOT DOWNRIGHT DISLOYAL.

ADR IS ONLY ONE ALTERNATIVE, NOT THE METHOD OF CHOICE.



Most lawyers—and hence the companies they serve—still view ADR as the alternative rather than the primary or preferred method of settling disputes.

Such companies see the procedure as a way of settling peripheral, less important disputes, or, as in the electronics case, they simply abandon it when they fail to get the result they want. In any event, they have not decided to make dispute avoidance and early resolution the prime mission of the legal department.

Even in companies where ADR has taken hold, there may be ways around the system. At Motorola, for example, at least ten circumstances can cause a dispute to be classified as an unsuitable candidate for early ADR, including "critical principle," "deterrent strategy," "the only issue is money," and "extremely complex factual issues."

ADR Isn't really all that different from litigation

Because few companies have made a serious commitment to ADR as a distinct system, and because there are very few rules governing it, the procedure is often allowed to become a litigation look-alike. Whenever that happens, the cost of ADR begins to approach the cost of the litigation that it's supposed to replace.

To cut down on attorney time, arbitration permits the parties to stipulate, or agree on, certain facts and virtually eliminate briefs, discovery, and the endless reliance on expert testimony and countertestimony. But the contending parties often waste prodigious quantities of time, money, and energy by reverting almost automatically to the habits of litigation. As happened in the electronics battle, lawyers make repetitious presentations of facts and legal arguments as if they were appearing before a judge rather than an arbitrator. They pursue discovery, file motions, and rely excessively on expert witnesses—exactly the way they would in a lawsuit. Outside the courtroom, lawyers grind out publicity favoring their cause. Moreover, arbitrators themselves contribute to the problem by handing down damage awards that are beyond reason and contractual limits. Sometimes, they even award punitive damages.

ADR THAT WORKS

Ultimately, any company's view of arbitration and mediation boils down to whether or not top management insists on winning at all costs. In the case of Companies A and B, both of which had pledged to seek alternatives before taking court action, belligerence and litigious habits undermined good intentions. Both sides felt they had been wronged and wanted the antagonist to pay. A confrontational atmosphere tainted the action from the start, and the judge made matters worse. It is no easy matter to make ADR systematic and to give it top priority in resolving conflicts.

At NCR and many other companies we know of, including AT&T, US WEST, BankAmerica, and Chevron, top management has decided that winning at all costs is too expensive. These companies evaluate lawyers, contract managers, and paralegals not merely on lawsuits won or lost but also on disputes avoided, costs saved, and the crafting of solutions that preserve or even enhance existing relationships. The legal departments use quantified measures and objectives to reduce systematically the number of lawsuits pending, the amount of time and money spent on each conflict, and the amount of financial exposure. As a result of this kind of attention, NCR succeeds in resolving and closing more than 60% of filed cases within a year of their being opened.

NCR evaluates its lawyers not only on lawsuits won or lost but also on disputes avoided and relationships preserved.

NCR requires all of its commercial contracts to include a clause specifying ADR as the first, preferred method of settlement should a disagreement arise. (See the insert "NCR's Standard Contract Clause.")

The corporate law department is built around a dispute avoidance and resolution process. Under this policy, staff ombudspersons (or, as NCR prefers to call them, ombuds) trained in problem solving, dispute avoidance, negotiation, and dispute resolution record and monitor all claims by or against the company.

Each case is reviewed to ascertain whether it should be arbitrated or litigated. Performance measures ensure that the procedure has teeth.

At NCR, as well as at AT&T, an ombud analyzes each case at the outset in order to assess objectively the financial exposure posed by the claim. The written analysis, distributed to management, includes an ADR plan and suggestions on how to strengthen the relationship with the opponent.

If the case can be handled through ADR at or below the calculated risk-exposure level, the company will proceed to resolve it without litigation.

The overall aim is to resolve the contention efficiently with little expenditure of time and money.

The acid test of an organization's dedication to quiet dispute resolution comes when the company is the complainant. In this circumstance, few companies seriously consider negotiation.

At NCR, however, management insists that resolution is preferable to litigation even when the company is convinced it's in the right.

Without the commitment of top management, ADR quickly turns into litigation-in-disguise.

ADDING TO ADR'S REPUTATION AS NOTHING MORE THAN LITIGATION-IN-DISGUISE IS THE POPULARITY OF COURT-ANNEXED ADR, WHICH JUDGES IN FEDERAL JURISDICTIONS OFTEN MANDATE AFTER CONTESTANTS HAVE ALREADY BEGUN TO LITIGATE. NOT SURPRISINGLY, THE PARTIES TEND TO PURSUE THE CASE AS THEY BEGAN IT—WITH A LOT OF HOSTILITY AND ALL THE EXPENSIVE PARAPHERNALIA OF A LAWSUIT—DESPITE THE JUDGE'S ADMONITION TO ARBITRATE. WHAT'S MORE, IF EITHER PARTY OBJECTS TO THE ARBITRATION DECISION, IT CAN TAKE THE CASE BACK TO THE JUDGE. DESPITE THE DRAWBACKS—HIGH LEGAL COSTS, LOST TIME, LACK OF FINALITY—SOME 65% OF CASES FACILITATED BY THE AMERICAN ARBITRATION ASSOCIATION ARE COURT-ANNEXED ADR.

Few companies consider arbitration when they are convinced they're in the right.

In 1992, for example, NCR discovered that one of its suppliers had sent it computer boards that did not conform to specifications. NCR wanted to return the boards for a refund, but the vendor refused to cooperate on the grounds that NCR had not complained in a timely manner and that, in any event, the supplier could fix the defect. NCR did not want the goods repaired, because improved technology introduced in the interval had made the items virtually obsolete. NCR offered to compromise by returning the boards and claiming only a partial refund or a credit toward future orders of other products. The supplier declined to give a refund in any form, vowed to undertake a legal battle, and hired a large law firm.

Sticking to its policy, NCR declined to enter into litigation. Instead, it filed an arbitration demand. The vendor's counsel tried to throw the process off track in a number of different ways. First he objected to arbitration, then he protested the hearing venue, then he introduced a motion for discovery. But the American Arbitration Association dealt with those roadblocks, succeeded in scheduling an arbitration session, and, several days before the hearing, the parties settled.

This case illustrates the routine though not negligible matters that arbitration handles particularly well. When each party's position has some merit, disputes over goods almost always end the same way: the party holding the cash decides to pay up before the case goes to trial. Here again, the prospect of arbitration quickly brought the case to its virtually predestined end, with a result almost certainly better than litigation could have achieved. Working through in-house counsel, NCR laid out less than $5,000. In contrast, because it retained counsel and dragged its feet on arbitration, the vendor spent more than $20,000, only to wind up with a result close to what NCR had proposed in the first place.

This case also illustrates the benefits that can stem from the single-minded avoidance of litigation. On the basis of its own analysis, NCR gave the supplier's claim some credence. NCR then made settlement offers built around credits to be applied to future business. When negotiation failed, the ombud pursued arbitration. Even after the hearing date had been set, the ombud continued doggedly to pursue negotiation and finally hit pay dirt.

In organizations where a preference for ADR has taken hold, fresh approaches to conflict tend to bubble up almost on their own. One example is the Toyota Reversal Arbitration Board mentioned earlier, which is a nonbinding mechanism to settle disagreements with its dealers
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In companies where a preference for ADR has taken hold, fresh approaches to conflict tend to bubble up almost on their own.

Toyota's legal department set up the board at a time when negotiation was already a firmly established part of the company culture. The board had three distinctive features. First, it laid down rules for the arbitration process rather than allowing the process simply to develop on its own. Second, it made arbitration decisions binding on Toyota but allowed dealers to appeal. By underscoring the fairness of the procedure, this feature of the program has had the unexpected effect of actually increasing dealer acceptance of arbitration results. Third, it set up an open file of case histories, which has allowed Toyota and its dealers to cite relevant precedents and thus cut straight to a resolution of many disputes without laboring through the entire arbitration process. Because most disputes are similar, dealers with very little legal expertise can work through the details and find helpful patterns.

- **Toyota made arbitration decisions binding on itself but gave dealers the right to appeal.**
- **Many companies can avoid disputes by analyzing root causes and acting on that analysis—an indispensable part of the peaceful approach.**
- **A further positive outcome was Toyota's decision to amend the sales-credit program that had provoked much of the contention in the first place.**
- **Toyota's experience is typical of initiatives taken by many companies to avoid disputes by analyzing root causes and acting on the analysis—an indispensable aspect of the peaceful approach.**

Make sure it's really arbitration

Many companies have developed arbitration not so much to hold down as to disguise both costs and unnecessary procedures. As a result, arbitration is more expensive than it should be, and critics claim, with some justification, that ADR's cost-cutting ability is exaggerated. NCR has set up guidelines to deal with this problem. It has found that arbitration looks like, feels like, and works like arbitration when the parties are prepared to pursue the following goals.

Streamline the proceedings.

The parties agree to stipulate undisputed facts and matters of law and to encourage the arbitrator to rule on disputed matters of law in summary form before hearing evidence. The arbitrator should specify which issues are most likely to generate disputes, and he or she should carefully avoid asking the parties to submit prehearing briefs on other issues, which is inevitably a waste of time and resources.

Limit the necessity for briefs.

In some cases, no briefs are needed at all. For example, when NCR is the claimant in a hearing called to collect money on an account, the company usually cites the law orally or submits a photocopy of the relevant statute to the arbitrator. Even when briefs are appropriate—on developing matters of law, say, or where court decisions conflict—NCR has found that their greatest usefulness is in focusing attention on key issues. Arbitrators should be asked to identify the issues on which they want the parties to write briefs. NCR has even gone so far as to ask arbitrators to set page limits on briefs.

Participate in prehearing exchanges.

Prehearing exchanges are invaluable in smoothing the way toward a resolution. The parties trade exhibits and witness lists, and discuss which items are important to the case and which peripheral. It is very important that these exchanges not resemble the discovery process typical of litigation; they should focus instead on documents to be used in the hearing. Prehearing exchanges often lead to a reduction in the witness lists and to having less important witnesses submit their testimony by affidavit or even by telephone.

Agree to limit damages.

In order to restrict discussion and head off problems, NCR has drafted damage limitations into the standard ADR clause it includes in all commercial contracts. In many cases, there is or should be no legitimate argument about the amounts in dispute, which makes extensive damage proof unnecessary. Where possible, parties should stipulate the extent of damages and the arbitrator should rule on the reasonableness of damage limitations before hearing evidence. In more complicated cases, NCR may go so far as to exact agreement on a dollar floor or ceiling or on so-called baseball arbitration to keep the amount to a reasonable level. (In baseball arbitration, each party picks a figure and the arbitrator must choose one or the other.)

Use experts selectively.

In adversarial proceedings, each side typically tries to outexpert the other; in arbitration, a limit on the use of experts saves time and money. For instance, instead of retaining opposing damage experts whose testimonies are likely to conflict, it makes good sense for both parties to agree on a single, neutral expert. This person's report puts pressure on the two sides to negotiate, whereas divergent, partisan reports encourage opponents to dig in and harden their positions.

Instead of retaining opposing experts whose testimony conflicts, both parties should agree on a single, neutral expert.

NCR has used the "neutral expert" effectively in other situations as well, including accident investigation and reconstruction, auditing and accounting, and technology issues. One effective use of expert testimony is to ask each party and the arbitrator to submit key questions for the expert to examine. In some areas—technology, for example—the expert can play a role in root-cause analysis by recommending improvements in products or practices. This is a much more constructive activity than merely offering a partisan opinion.

The standard ADR clause inserted into all NCR commercial contracts has many features that help ensure that arbitration will really be arbitration and not camouflaged litigation. Among them are guidelines on the qualifications of the arbitrator, empowerment of the arbitrator to grant injunctive relief, an agreement that challenges to arbitration or award decisions be governed by federal arbitration law (and that the challenger must pay costs and fees if it loses), and limitations on discovery.

The Process SystematizedBoosting commitment to ADR and avoiding the trap of litigation-in-disguise are both important steps in the effort to replace confrontation with negotiation. The essential third step is to create a systematic process that mandates ADR as the first step in every legal action. At NCR, the Dispute Avoidance Resolution Process, called DARP, begins when the ombud reviews the dispute, regardless of whether NCR has initiated the complaint or another party has named NCR as respondent.

By DARP rules, every dispute is entered into a PC database within 24 hours of its inception, and everyone at NCR who needs to know is notified, from those involved in the complaint to those who may help to resolve it. Within three days, NCR notifies opposing counsel that it is addressing the problem with a view toward peaceful resolution.

Another distinctive feature of NCR's system is the way its law department monitors the process and measures the performance of its ombud according to the number of issues resolved, the number resolved without litigation, the quality and permanence of solutions, the efforts made to analyze disputes and identify ways of preventing similar occurrences in the future, and the precise amount of time and money saved through efficient ADR.

To see how this system works, let's follow an actual dispute between NCR's computer systems division and a big passenger carrier.

The division's installation of computer hardware went well. Then came a glitch: while the contract called on NCR to supply one repeated-use, or multipass, ribbon cassette for each printer, it turned out that no vendor could deliver a multipass ribbon to the specs of the printers designed for the project. The project team, which included representatives of both companies, accepted NCR's proposal to furnish several single-pass ribbons per printer instead.

Several months later, some executives of the carrier raised the matter of the multipass ribbon once again. Despite NCR's explanations, they referred back to the wording of the original contract in meeting after meeting, and in increasingly hostile tones. Soon the amicable relationship had deteriorated, and each meeting became a rehash of previous encounters. The customer stopped making payment on the contract, to the tune of some $250,000. On the heels of this action came a letter from the customer's in-house counsel, who wrote that the carrier wanted relief not for the undelivered ribbo+ns but for the added costs over several years of using the single-pass cassettes, amounting to several hundred thousand dollars.

A healthy business relationship had gone sour over a small matter. At this point, the problem could easily have become irretrievable, but NCR's Dispute Avoidance Resolution Process succeeded in untangling the mess. DARP's basic features should form the foundation of any such system.

The system kicked in immediately.

As soon as the customer's letter arrived, DARP went into play. The ombud (in this case, an in-house lawyer) immediately telephoned the customer's counsel to pinpoint the nature of the problem and discuss the contract provisions in dispute. A paralegal well versed in DARP procedure was assigned to investigate the situation and look for possible solutions (including a review of alternative sources of multipass ribbons). The ombud had the contract and some key related documents collected, analyzed, and summarized.

She also interviewed several NCR employees who had played critical roles in the history of the dispute.

The ombud quickly narrowed the issues.

The ombud discussed the problem with the customer's representatives and reviewed the contract's dispute resolution clause. The two sides soon reached agreement on the chronology of the project, and they stipulated a list of events and the specifics of the contract. They then decided to bypass the project team, with all its emotional baggage, and put the matter into the hands of senior managers.

An executive-level negotiation was tried first without lawyers or the managers directly involved in the dispute.

NCR wanted to make clear to the customer that it valued the relationship and that the matter of the contract was subordinate to maintaining that tie. The customer was similarly well intentioned. So the two sides agreed on a negotiation between executives, without lawyers or project managers, although a few people acquainted with the project and the contracts were on hand in the room. Each side was represented by an executive with decision-making authority who had no previous connection with the project.

Preparation was painstaking.

The key to successful negotiation is preparation. The ombud worked long hours with the participants well ahead of the meeting. Each participant received a notebook containing the contract itself, interview summaries, and lists of essential stipulated facts. The ombud and her team also came up with a litigation risk analysis that laid out the economic exposure for both sides and brainstormed a variety of solutions that acknowledged the customer's interests as well as NCR's.

The tone of the negotiation was positive.

After agreeing to the facts of the case, the executives traded compliments. The customer's representative declared that his company was well satisfied with the system, and the NCR representative made it clear that his company wanted to have the customer's continuing business. The two executives considered many possible solutions and agreed on one of them after only a few hours of talk. That solution involved neither a financial settlement nor provision of multipass cassettes but an alteration in the design of the printer so that it could use a different and commonly available multipass ribbon.

NCR estimated that this method of resolving the dispute saved it as much as $ 200,000 and that it saved the carrier a similar amount. Litigation would have run the costs much higher while expending valuable internal resources. Even then, the confrontation would only have produced a winner and a loser, not a solution to the joint problem of the ribbons.

Litigation tends

to produce

only winners and losers

not solutions

to joint problems.

No ADR plan will ever prevent all litigation, but none will come close without the wholehearted commitment of company management. At NCR, with that kind of commitment firmly in place, there are really three keys to success. The first is time. Disputes age badly, so the DARP system is designed to report, analyze, address, and resolve them before they can fester into litigation.

The second is persistence. NCR's ombuds not only act quickly, they also act thoroughly. They notify all relevant parties, they examine history and background in detail, they go out of their way to understand their opponent's point of view, they take great pains in preparing their negotiations, and, most important, they don't give up. They generate a range of potential solutions, and when one form of ADR fails to resolve the problem, they invariably propose another.

The third reason why DARP works is that NCR continuously reevaluates and improves the system. The company subjects each case to a postmortem, refines its procedures accordingly, and adds to its stock of insights. DARP is now the beneficiary of years of trial and error in ADR proceedings.