DESIGNING A CONTRACTUAL DISPUTE PREVENTION, DE-ESCALATION AND REAL-TIME RESOLUTION SYSTEM

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No single process or contract clause can serve all of the dispute prevention and resolution needs of a business relationship. Therefore, the best practice for achieving maximum dispute prevention and resolution results is to include in the basic relationship contract a well-planned "system" for prevention, control, and final resolution of any disputes. Dispute resolution system design is simply a process of analyzing the likelihood that a particular relationship will experience disputes, predicting the kinds of disputes that might arise, and then incorporating into the contract a succession of techniques, filters, screens, and safety nets—using the available tools and techniques—to deal with a succession of different types of problems at different stages in the life of the relationship, so that problems are likely to be resolved at the earliest possible time.

One of the most important elements in the effectiveness of a dispute resolution system is for the parties to initiate the system at the beginning of the relationship and incorporate it into the basic contract documents. Without prior agreement on a process for dealing with problems and disputes, it can be difficult, after a disagreement has developed, to get parties to come to agreement on a method of dispute resolution. A process that is already in place will provide a method for absorbing the impact of a problem; however, without a process, there is no effective way to control the outcome.

Every dispute resolution system should contain a progression of tools that can be used to prevent, de-escalate and resolve disputes. Such a system moves the dispute process "upstream," closer in time to the sources of disputes. It has a succession of "steps" that incorporate techniques to deal with various kinds of problems at different stages in the development of a dispute, such as techniques for prevention, techniques for control and de-escalation, a "real time" standing neutral, a process for nonbinding resolution, and finally a "backstop" final resolution process.

SPECIFIC DISPUTE PREVENTION TECHNIQUES AND ILLUSTRATIVE LANGUAGE

The contract planning and negotiation stage is the logical starting point for articulating techniques that have been proactively selected by the parties to prevent, control, reduce and achieve the earliest possible resolution of disputes. The existence in the contract of proactive techniques for handling disputes, and the parties' knowledge that these techniques are readily available, should direct any disputes into channels where they can be dealt with constructively. In many cases the mere availability of these processes will encourage the parties to act more forthrightly with one another and settle their disputes without the necessity of using any of the

prescribed techniques.

These proactive techniques are not rigid; they can be adapted to meet the needs of the parties, or the nature of the particular dispute. Prevention processes help to de-escalate potential disputes; they achieve real-time resolution of disputes before they erupt into intractable disputes; and they involve minimal transaction costs, as compared with the very high transaction costs that can be associated with mediation, arbitration and litigation.

The following summary describes several well-developed dispute resolution tools with which every lawyer should be familiar. These tools form a spectrum of techniques in the order in which they would normally be employed in the life of the dispute, beginning with the techniques that help most in preventing or controlling disputes and offer the greatest potential for saving money and preserving relationships. They can be grouped into the following four successive and escalating stages of dispute resolution: cooperation and dispute prevention stage; dispute control stage; nonbinding facilitated resolution stage; and binding resolution stage. This paper will deal with only the first two stages.

Cooperation and dispute prevention stage

Realistic allocation of risks

Research by The Business Roundtable has demonstrated that one of the most powerful ways to prevent and control disputes between contracting parties is to rationally allocate risks by assigning each potential risk of the business relationship to the party who is best able to manage, control or insure against the particular risk. Conversely, unrealistic shifting of risks to a party who is not equipped to handle the risk can increase costs, sow the seeds of countless potential disputes, create distrust and resentment, and establish adversarial relationships that can interfere with the success of the business enterprise.

Unfortunately, this fundamental principle of good business management and dispute prevention is not widely recognized or understood. In particular, lawyers involved in contract negotiations for their clients who seek zealously to obtain the “best possible deal” by shifting all possible risks to the other party can sometimes create problems of a far greater magnitude than any temporary benefit or satisfaction gained by “winning” the “battle” of the contract negotiations.

Realistic risk allocation promotes efficiency, lowers costs, and creates better relationships. The result in nearly all cases will be fewer disputes and a greater chance for success of the enterprise.

In many cases it will be obvious that certain risks logically should be assigned to a particular party. Other risks can possibly be handled equally well by either party, and some risks may be such that they cannot be effectively handled or even insured against by either party; the assignment of those risks will have to be dealt with through bargaining, and the result of that bargaining will likely be reflected in the economic terms of the deal.

In a one-time, short-term transaction between two parties who never expect to do business again with each other, it may not make a difference to anyone but the parties themselves if the party

with superior bargaining power shifts to the other party risks that the other party can't control. However, in any business relationship of long duration or where there are repeated transactions, there are advantages to having a balanced relationship where neither party is exposed to inordinate risk, and where both parties profit. In multiple-party relationships, realistic assignments of risk are particularly important to the maintenance of healthy relationships and control of costs. In the classic multi-party example of the construction industry, an owner's use of superior bargaining power to shift risks unrealistically to another party typically creates a chain reaction of cost inflation, resentment, downstream risk-shifting, defensive and retaliatory tactics, and misunderstandings caused by different perceptions as to the enforceability of some risk-shifting provisions. The result is usually adversarial relationships, disputes and claims, all or most of which could have been avoided by intelligent sharing of risks.

Partnering

Partnering is a team-building effort in which the parties establish cooperative working relationships through a mutually developed, extra-contractual strategy of commitment and communication. It can be used for long-term relationships, or on a project-specific basis. The relationship is based upon trust, dedication to common goals, and understanding of one another's individual expectations and values. The expected benefits from such a relationship include improved efficiencies and cost-effectiveness, increased opportunity for innovation, and continual improvement of quality products and services.

When used on a project-specific basis, partnering is usually instituted at the beginning of the relationship by holding a retreat among all personnel involved in the project who have leadership and management responsibilities, in which the participants, assisted by an independent facilitator, become acquainted with one another's objectives and expectations, recognize common aims, develop a teamwork approach, initiate open communications, and establish nonadversarial processes for resolving potential problems.

Partnering can be initiated on an *ad hoc* basis, or by the contract. It is essentially a good-faith and non-contractual process. If initiated under the contract, care should be taken to preserve the extra-contractual nature of the process, unless the parties consciously decide that certain aspects of their partnering relationship should take on the status of contractual obligations.

A typical provision for initiating the voluntary partnering process would be as follows:

> *VOLUNTARY PARTNERING*
>
> *The parties intend to encourage the foundation of a cohesive partnering relationship that will be structured to draw on the strengths of each organization to identify and achieve reciprocal goals, to accomplish the objectives of the contract for the mutual benefit of all parties.*
>
> *This partnering relationship will be bilateral, and participation will be totally voluntary. Any cost associated with effectuating this partnering relationship will be agreed to by all parties and will be shared equally.*

To implement this partnering initiative, at the beginning of the relationship representatives of the parties will initiate a partnering development seminar and team-building workshop. These individuals will make arrangements to determine attendees at the workshop, agenda of the workshop, duration, and location, and will engage an independent facilitator. Persons required to be in attendance at the workshop will be key personnel from all organizations who are involved in operations under the contract. Representatives of organizations not parties to the contract may also be invited to attend as necessary or appropriate. Follow-up workshops may be held periodically throughout the duration of the contract as agreed by the parties.

The establishment of a partnering charter will not change the legal relationship of the parties to the contract nor relieve any party of any of the terms of the contract.

Contractual terms that can enhance the partnering relationship

Some people, particularly in the construction industry, believe that the best partnering relationships are founded on an explicit contractual commitment of good faith and reasonable (or fair) dealing. The laws of many countries impose an implied obligation of good faith and fair dealing in every contract. If the parties want to contractually confirm this kind of relationship, they can include an explicit contractual covenant of good faith and fair dealing, along the following lines:

The parties, with a positive commitment to honesty and integrity, agree to the following mutual duties:

a. *Each party will act in good faith and engage in fair dealing;*
b. *Each will assist in the others' performance;*
c. *Each will avoid hindering the others' performance;*
d. *Each will proceed to fulfill its obligations diligently;*
e. *Each will cooperate in the common endeavor of the contract.*

Incentives to encourage cooperation

Where a business is contracting with multiple organizations that have diverse interests, and where the cooperation of all of these organizations with one another is important to the success of a transaction or business objective, it is often helpful to structure a system of incentives to encourage such cooperation. Well-conceived positive incentive programs can be an effective means of aligning the goals of all of the participants, can encourage superior performance, and can discourage conflict. Such incentives can take many forms. One example of such an incentive system is where the leader of the enterprise establishes a bonus pool that, upon attainment of specific goals, will be shared among all of the people with whom the leader organization contracts. Under such a system the bonus is payable only if all of these participants as a group meet the assigned goals; the bonus is paid either to everyone, or to no one. This device provides a powerful incentive to the participants to work cooperatively with one another, and reduces conflicts that can occur in a common enterprise when every participant might otherwise be motivated solely by its limited perception of its own short-term interests, rather than the success

of the enterprise as a whole. It encourages participants to subordinate their individual interests temporarily to the legitimate needs and success of the enterprise as a whole, for the ultimate benefit of all project participants. The relatively low cost of the bonus pool in relation to the budget of the overall enterprise can pay great dividends when it helps to achieve success for the venture.

Following is an example of language establishing an incentive plan, taken from a construction contract, where the general contractor, using funds provided by the owner of the project, seeks to encourage cooperative behavior among the subcontractors who are collectively performing the bulk of the on-site construction work:

> *BONUS POOL PLAN*
>
> *The General Contractor will establish a Bonus Pool program offering every Subcontractor a cash incentive for achieving the Project Goals outlined below:*
>
> *The Project Goals are:*
> a. *The project is completed by the Completion Date;*
> b. *There are no unresolved claims by any Subcontractor for interference or damage by any other Subcontractor or Contractor; and*
> c. *There have been no accidents that have caused more than __ work days to be lost.*
>
> *If all of the Project Goals are achieved, the General Contractor will pay to each Subcontractor, in addition to each Subcontractor's normal compensation, a bonus of __% of the Subcontractor's adjusted contract sum.*

Dispute control stage

Negotiation

Negotiation is the time-honored method by which parties try to resolve disputes through discussions and mutual agreement. Negotiation is not only a freestanding dispute resolution technique, but also it can be a useful adjunct to every other dispute control and resolution technique.

A variant of negotiation is the "step negotiation" procedure, a multi-tiered process that can often be used to break a deadlock. If the individuals from each organization who are involved in the dispute are not able to promptly resolve a problem at their level, their immediate superiors, who are not as closely identified with the problem, are asked to confer and try to resolve the problem; if they fail, the problem is then to be passed on to higher management in both organizations. Because of an intermediate manager's interest in keeping messy problems from bothering higher management, and in demonstrating to higher management the manager's ability to solve problems, there is a built-in incentive to resolve disputes before they ever have to go to the highest management level.

Following is a contract clause committing the parties to good faith negotiation:

> *GOOD FAITH NEGOTIATION*
>
> *The parties will attempt in good faith to resolve promptly any controversy or claim arising out of or relating to this agreement by negotiation between representatives of the parties who have authority to settle the controversy.*

The following paragraphs will implement a step negotiation process:

> *STEP NEGOTIATIONS*
>
> *If a controversy or claim should arise, the parties will attempt in good faith to promptly resolve any controversy or claim arising out of or relating to this agreement by step negotiations among managers and executives of the parties who have authority to settle the controversy.*
>
> *If the controversy or claim cannot be resolved promptly by the representatives of the parties at the operational level, then _____ and _____ (the middle level managers for each party) will meet at least once and will attempt to resolve the matter. Either manager may request the other to meet within seven days, at a mutually agreed time and place.*
>
> *If the matter has not been resolved within ten days of their first meeting, the managers shall promptly prepare and exchange memoranda stating the issues in dispute and their position, summarizing the negotiations that have taken place and attaching relevant documents, and shall refer the matter to _____ and _____ (senior executives of each party), who shall have authority to settle the dispute. The senior executives will promptly meet for negotiations to attempt to settle the dispute.*
>
> *If the matter has not been resolved within ten days from the referral of the dispute to senior executives, either party may refer the dispute to another dispute resolution procedure.*

Standing neutral, standing mediator or standing arbitrator

One of the most innovative and effective developments in controlling disputes between parties who are involved in any type of long-term relationship (such as a joint venture or construction project) is the concept of the pre-selected or standing neutral to serve the parties as a "real time" dispute resolver throughout the course of the relationship. This neutral, or a board of three neutrals (designated variously as a "standing neutral," "mutual friend," "referee," "dispute resolver," or "dispute review board") is selected mutually by the parties early in the relationship; is briefed on the nature of the relationship; is furnished with the basic documents describing the relationship; routinely receives periodic progress reports as the relationship progresses; and is occasionally invited to meet with the parties simply to get a feel for the dynamics and progress of

the relationship. The standing neutral is expected to be available on relatively short notice to make an expert recommendation to the parties to assist them in resolving any disputes that the parties are not able to resolve themselves. It is important to the effective working of this process that the parties be mutually involved in the selection of the neutral, and that they have confidence in the integrity and expertise of the neutral. Typically the neutral's role, if called in to help resolve a dispute, is to render an impartial nonbinding recommendation concerning the subject matter of the dispute.

Although the standing neutral's decisions are typically not binding, experience has shown that neutrals' recommendation have generally been accepted by both parties, without any attempt to seek relief from any other tribunal. This result is enhanced where there is a contract requirement that in the event of any subsequent arbitration or litigation, the recommendation of the standing neutral will be admissible in evidence. Three critical elements are essential to the success of the standing neutral technique:

1. Early mutual selection and confidence in the neutral.
2. Continuous involvement by the neutral.
3. Prompt action on any submitted disputes.

The existence of a pre-selected neutral—already familiar with the business relationship between the parties and its progress—avoids many of the initial problems and delays that are involved in selecting and appointing neutrals after a controversy has arisen. The ready availability of the neutral, the speed with which he or she can render recommendations, and particularly the fact that this neutral will hear every dispute that occurs during the history of the relationship, all provide powerful incentives to the parties to deal with one another and the neutral in a timely and frank manner, by discouraging game-playing, dilatory tactics, and the taking of extreme and insupportable positions. In practice, the nature of this process is such that the mere existence of the neutral always results in minimizing—and often totally eliminating—the number of disputes that have to be presented to the neutral. Even though some expense is involved in the process of selecting, appointing, initially orienting, and periodically reporting to the neutral, the costs are relatively minimal, even when the neutral is called on to resolve disputes.

The use of a standing neutral is especially advantageous before advocates have been summoned and before positions have hardened. This is an especially critical stage in the evolution of a dispute. It is likely the last best opportunity to bring about a problem-solving approach to a budding conflict, and the ready availability and wisdom of a standing neutral at that point can usually bring about a solution to the problem.

One of the greatest advantages of having a standing neutral is that in effect, the standing neutral serves not only as a standby dispute *resolution* technique but also as a remarkably successful dispute *prevention or control* device. The advantage of having a "standing" dispute resolver looking over the shoulders of the parties cannot be overestimated, as the "Hawthorne Effect" of being watched generally results in improved behavior.

Even though some modest expense is involved in the process of selecting, appointing, initially orienting, and periodically keeping the neutral informed about the relationship, the costs are

relatively minimal, even in those rare cases where the neutral has to be called on to resolve disputes—especially when compared to the potential costs of resolving a dispute in arbitration or litigation, or even the expense of mediating a dispute after the project is completed.

The standing neutral concept was first used in the construction industry, which has developed standard detailed specifications for the establishment and operation of such a process, using either a group of three neutrals called variously a "dispute review board" or a "dispute resolution board" or a single "dispute resolver." This process is readily transferable to other industries. Parties who wish to set up a standing neutral process can refer to such sources as the Dispute Resolution Board Foundation (www.drbf.org), the American Arbitration Association (www.adr.org), the International Chamber of Commerce, or the standard documents of the Federation Internationale Des Ingenieurs Conseils (FIDIC) (www.fidic.org), and adapt the language to the specifics of the particular business relationship or transaction.

In the construction industry, the recommendations of a standing neutral are typically merely advisory. However, in certain business contexts, the parties may wish to treat the standing neutral's recommendations as binding decisions. In this case the standing neutral becomes a standing arbitrator, and the operative contract language—in addition to providing for the continuing nature of the standing neutral's assignment—should also contain appropriate language that makes the decisions binding under the applicable arbitration statute, and reference the arbitration rules of an established arbitration agency.

Following are typical clauses that parties can use to establish a standing neutral process that can be adapted, as appropriate, to cover the many available roles that a standing neutral can perform.

> *AGREEMENT FOR STANDING NEUTRAL*
>
> *The parties will, either in their contract or immediately after entering into their contractual relationship, designate a Standing Neutral who will be available to the parties to assist and recommend to the parties the resolution of any disagreements or dispute that may arise between the parties during the course of the relationship.*
>
> ***Appointment.*** *The neutral will be selected mutually by the parties. The neutral should be experienced with the kind of business involved in the parties' relationship, and should have no conflicts of interest with either of the parties.*
>
> ***Briefing of the neutral.*** *The parties will initially brief the neutral about the nature, scope and purposes of their business relationship and equip the neutral with copies of basic contract documents. To keep the neutral posted on the progress of the business relationship, the parties will furnish the neutral periodically with routine management reports, and may occasionally invite the neutral to meet with the parties, with the frequency of meetings dependent on the nature and progress of the business venture.*
>
> ***Dispute resolution.*** *Any disputes arising between the parties should preferably be resolved by the parties themselves, but if the parties cannot resolve a dispute, they will promptly submit it to the neutral for resolution.*

Conduct of hearing and recommendation. *As soon as a dispute has been submitted to the neutral, the neutral will set an early date for a hearing at which each party will be given an opportunity to present evidence. The proceedings should be informal, although the parties can keep a formal record if desired. The parties may have representatives at the hearing. The neutral may ask questions of the parties and witnesses, but should not during the hearing express any opinion concerning the merits of any facet of the matter under consideration. After the hearing the neutral will deliberate and promptly issue a written, reasoned recommendation on the dispute.*

Acceptance or rejection of recommendation. *Within two weeks of receiving the recommendation, each party will respond by either accepting or rejecting the neutral's recommendation. Failure to respond means that the party accepts the recommendation. If the dispute remains unresolved, either party may appeal back to the neutral, or resort to other methods of settlement, including arbitration (if agreed upon by the parties as their binding method of dispute resolution) or litigation. If a party resorts to arbitration or litigation, all records submitted to the neutral and the written recommendation will be admissible as evidence in the proceeding.*

Fees and expenses. *The neutral shall be compensated at his or her customary hourly rate of compensation, and the neutral's compensation and other reasonable costs shall be shared equally by the parties.*

Succession. *If the neutral becomes unable to serve, or if the parties mutually agree to terminate the services of the neutral, then the parties will choose a successor Standing Neutral.*

DISPUTE RESOLUTION CLAUSES

It's not the province of this paper on dispute prevention, de-escalation and real-time clauses to deal with intractable disputes. However, any well-crafted dispute prevention and resolution system should recognize that if the parties have an intractable dispute, they will have to bring in outside professional help from third parties to get their dispute resolved. So the parties would be wise to include in their contract a nonbinding facilitated resolution process such as mediation. Then if all other efforts at resolution have failed, they will have to resort to a "backstop" adjudication process to achieve final resolution, such as arbitration or, if they have not chosen arbitration, by default, litigation.

REFLECTIONS AND OBSERVATIONS

It may illuminate the reader's understanding of the foregoing recommendations to list a few terms and expressions that characterize the proactive approach to dispute prevention and de-escalation:

- Anticipate.
- Think ahead.
- Be proactive.
- Realistically recognize the inevitability of experiencing problems and unexpected surprises.
- Address every problem as soon as it is identified.
- Concentrate on fixing the problem, not the blame.
- Collaborate and cooperate.
- De-escalate tensions. Use flexible prevention and de-escalation processes that can be adapted to any potential situation.
- Use incentives to encourage constructive behavior.
- Preserve valuable commercial relationships.

In 2016 and 2017, in the Global Pound Conference initiative (named in honor of Roscoe Pound, the legendary advocate of improving dispute resolution processes), the worldwide dispute resolution community explored ways to improve the dispute resolution process. Delegates to the 29 Global Pound Conferences held throughout the world as a part of that initiative demonstrated an increasing interest in prevention, control, and early resolution techniques. The delegates to those Conferences were asked to vote their preferences for dispute prevention and resolution processes. In the overall voting, the delegates heavily favored, as tools that *should be prioritized to improve the future of dispute resolution*, "pre-dispute or pre-escalation processes to prevent disputes." This is a concept whose time has come.

(It should be noted that the suggestions in this paper regarding use of contract language are not intended and should not be taken as legal advice.)