

“MED-ARB - PAST, PRESENT AND POTENTIAL”

by

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- 1 What is Med-Arb? It is mediation followed by an arbitration, if the parties do not agree to settle their dispute at the mediation. The distinguishing feature is that the same person is both the mediator and the arbitrator.

The Past

- 2 Section 27 of the *Commercial Arbitration Act 1984 (NSW)* is **attached**. It permitted med-arb. It does not seem to have been used much, if at all.
- 3 The obvious advantage of med-arb is that the same person mediates and then arbitrates. As a result, they will be familiar with the parties and the dispute by the time they arbitrate because of the mediation. That should save time and costs. The parties get all the benefits of an opportunity to settle their dispute by mediation but, if mediation is not successful, they are guaranteed an adjudicated result by the arbitrator.
- 4 There are two sorts of perceived problems with med-arb that may explain why it has not been used: behavioural problems and natural justice problems.
- 5 **Inhibition:** The first behavioural problem is that the parties may be **inhibited from being frank** with the mediator because of fear that the information they give the mediator will be used against them if they arbitrate.
- 6 In negotiation, it is rational to accept any settlement that is better than your BATNA - your Best Alternative To a Negotiated Agreement. In med-arb, a party's BATNA is the likely result of the arbitration. A party is unlikely to disclose to a mediator that it regards its prospects of success on liability in the arbitration as poor or that, on quantum, it has been advised that it will recover only 50% of the amount it claims. This is because, if the mediation is not successful, that party will submit to the arbitrator that it should be successful on liability and recover 100% of the amount it claims.
- 7 **Trial run:** This is the second behavioural problem. For fear of showing weakness, the parties may take positions based solely on their legal rights and entitlements as they perceive them at their highest. In other words, the parties regard the mediation simply as **a trial run for the arbitration**. This is likely to be a self-fulfilling prophecy.

- 8 **Undue pressure to settle:** This is the third behavioural problem. Suggestions by the mediator about how the dispute should be settled may be taken as foreshadowing how the arbitrator would frame the award. The parties may feel that, by doing this, the mediator is imposing **undue pressure on them to settle**.
- 9 There is a solution to each of the behavioural problems.
- 10 **Inhibition:** Use a mediator who employs facilitative mediation rather than evaluative mediation. A facilitative mediator understands the difference between a party's rights and its interests and therefore understands that there are many reasons to settle a dispute. A party with strong legal rights may nonetheless want to settle a dispute in order to preserve or promote a commercial relationship, or to preserve confidentiality, or because speed of settlement is important, or for many other reasons. If such matters are disclosed to a facilitative mediator, they will not be taken as admissions that the party's legal position on liability or quantum is weak.
- 11 **Trial run:** Again, the solution is to use a facilitative mediator. Such a mediator can make clear to the parties that he or she is aware there may be many matters relevant to how the matter is settled, apart from the strict legal rights of the parties. Once the mediator starts exploring the parties' interests, as distinct from their legal positions, it will be obvious that it is not productive to conduct the mediation as a trial run for the arbitration.
- 12 **Undue pressure to settle:** Once again, the solution is to use facilitative mediators, who do not suggest or recommend particular settlements. Instead, they encourage the parties to suggest and advocate them. The parties do not need to disclose and should not disclose their BATNAs to the mediator. Taking these two steps should avoid any sense that the mediator is exerting undue pressure on the parties to settle.
- 13 **Mediation and the rules of natural justice:** The first rule of natural justice is that a decision-maker must be unbiased. This rule does not apply in a mediation because a mediator does not make decisions that affect the parties' rights and entitlement.
- 14 The second rule of natural justice is that a party must have an opportunity to answer the case against it. It is for that reason that all evidence is given to a decision-maker in the presence of both parties. There are, of course, exceptional situations where a party temporarily can proceed *ex parte*.
- 15 The essence of mediation, however, is that the mediator meets privately with the parties and must keep confidential all information a party tells him or her in private, unless authorised by the party to disclose the information. The "*private session*" is central to mediation. The second rule of natural justice does not apply in mediation, again for the reason that a mediator does not make decisions that affect the parties' rights and entitlement.

- 16 **Med-arb and the first rule of natural justice:** The parties may fear that a mediator who expresses opinions about the parties' positions will retain those opinions when arbitrating and thus approach the arbitration with biases. In other words, the parties may feel that med-arb will lead to a breach of the first rule of natural justice.
- 17 Again, the solution to this problem is to use a facilitative mediator who does not express opinions about the parties' position.
- 18 **Med-arb and the second rule of natural justice:** If the mediator becomes the arbitrator, a party will not know what the other party told the mediator in confidence. The mediator may have been told things detrimental to the party's case and things favourable to the case of the other party. In neither case does the other party have a chance to respond to them.
- 19 The parties may fear that, as a result of what he or she was told in confidence, the arbitrator will be biased against them or for the other party, or both. The parties may also fear that even if the arbitrator is not biased, they may be influenced, when making the award - perhaps subconsciously - by information obtained in confidence during the mediation to which there was no opportunity to respond.
- 20 **A Hobson's choice:** The second rule of natural justice thus creates a Hobson's choice for the parties during the mediation part of a med-arb process:
- 20.1 Avoid the risk of a breach of the second rule by having a mediation without private sessions. Everything told to the mediator is imparted in the presence of both parties. However, the mediation is likely to be less effective because the mediator cannot use private sessions.
- 20.2 Have a mediation with private sessions. This will maximise the effectiveness of the mediation. However, a party will run the risk that, if the mediator becomes the arbitrator, they will be biased against that party because of information given to the mediator by the other party in private session.
- 21 There is no obvious answer to the problem created for med-arb by the second rule of natural justice. That probably is the central reason that med-arb does not seem to have been used.

- 22 It has been suggested that the parties could agree in advance that, if the mediation does not result in a settlement, each has the right to object to the mediator acting as arbitrator - in which case the arbitration must be conducted by someone else¹. The *Commercial Arbitration Act 2010* now provides a more effective solution.

The present

- 23 The *Commercial Arbitration Act 2010 (NSW)* passed through Parliament on 28 June 2010. On commencement, it repealed the *Commercial Arbitration Act 1984 (NSW)*: ss. 1B, 42. Section 27D of the new Act is **attached**. It provides for med-arb.
- 24 Section 27D(1) permits an arbitrator, with the parties' consent, to act as mediator before, after or during the arbitration. Section 27D(2) permits an arbitrator acting as mediator to meet separately with a party. If this happens, information obtained from a party must be treated as confidential unless the party agrees otherwise or the arbitration agreement provides otherwise.
- 25 Section 27D(4) introduces a second time at which the parties must consent to the mediator going on to arbitrate. An arbitrator who has acted as mediator must obtain written consent from all parties before conducting a subsequent arbitration. This provides a partial solution to the problem created for med-arb by the second rule of natural justice. If a party fears that the arbitrator will be biased against it because of information he or she obtained in confidence during the mediation, the party can decline to consent to the mediator acting as arbitrator.
- 26 However, the solution provided by s. 27D(4) is a pretty blunt instrument. The problem is that, by definition, a party will not know what information the other party has given the mediator in confidence. As a result, the party is likely to fear the worst and decline to consent to the mediator acting as arbitrator. If parties take this attitude, s. 27D(4) will solve the natural justice problem at the cost of med-arb not working.
- 27 Section 27D(7) contains a more refined mechanism for solving the second rule of natural justice problem. Section 27D(7) says:

“If confidential information is obtained from a party during mediation proceedings ..., the arbitrator must, before conducting subsequent arbitration proceedings ... , disclose to all other parties to the arbitration proceedings so much of the information as the arbitrator considers material to the arbitration proceedings.”

¹Alan Limbury, “*Making Med-Arb Work*”. This paper is available at http://www.strategic-resolution.com/med_arb.html. Mr Limbury's pioneering work on med-arb is the source of many of the ideas in this paper and is gratefully acknowledged.

- 28 So if, in the mediation, Party A discloses to the mediator items 1, 2, 3 and 4 in confidence, the mediation ends and the mediator wishes to arbitrate, he or she must disclose items 1, 2, 3 and 4 to Party B if the mediator considers them material to the arbitration.
- 29 Section 27D(7) does not make clear **when** the mediator must disclose confidential information. Is it before or after the parties consent to the mediator acting as arbitrator? If the parties' consent is required **before** the mediator discloses the confidential information, the same problem arises as with s. 27D(4) - a party, not knowing what confidential information the mediator may disclose, will fear the worst and not consent to the mediator acting as arbitrator.
- 30 It seems to me that a party could condition its consent under s. 27D(4) on being told beforehand what confidential information imparted by that party the mediator intends to disclose. The party thus could say to the mediator, "*I'm happy to consent to your acting as arbitrator, subject to your first telling me what confidential information you got from me you intend to disclose to the parties if you do.*" It would, however, be better if s. 27D(7) clearly provided that disclosure by the mediator **precedes** the consent of the parties.
- 31 Section 27D(7) provides some opportunity for abuse. Party A could condition its consent to the mediator arbitrating on first being told not only what confidential information of that party the mediator intends to disclose, but also on being told the confidential information of Party B, **the other party**, that the mediator intends to disclose. What if Party A had no intention of consenting to the mediator acting as arbitrator and just wanted to find out Party B's confidential information?
- 32 I think that this abuse can be prevented by the mediator refusing to disclose to Party A the confidential information of Party B until after Party A has consented to the mediator arbitrating. It is not entirely clear, however, that the mediator is entitled to do this.
- 33 Section 27D(7) has some significant practical implications for the parties, for their lawyers, and for the mediator:
- 33.1 A lawyer acting for a party should advise the party to be cautious about disclosing information to the mediator in private sessions. If the material is prejudicial to your client, the mediator may consider that it should be disclosed to the other party before arbitrating. That may lead your client to refuse to consent to the mediator arbitrating.
- 33.2 If the material disclosed by your client is prejudicial to the other party and the mediator discloses it, the other party may refuse to consent to the mediator arbitrating.
- 33.3 Whatever your client tells the mediator in private session potentially will not remain confidential, but will be disclosed to the other party by the mediator.

- 33.4 There is pressure to disclose and pressure not to disclose and the two pressures must be balanced against each other. There is pressure to disclose because the ability to disclose information in a private session, with the assurance that it will remain confidential permanently, can tremendously assist a mediation to succeed. There is pressure not to disclose because - despite the disclosure - the mediation may not succeed and the mediator may not be able to act as arbitrator without disclosing the information to the other party.
- 33.5 Balancing these pressures will require careful consideration with your client of the two factors. You should get clear instructions before disclosing information to the mediator.
- 33.6 From the mediator's point of view, s. 27D(7) seems to have the result that the mediator must record all information given to the mediator in private session. If this is not done, the mediator will not be able to form a judgement after the mediation about what information is material to the arbitration and must be disclosed.
- 33.7 My practice as a mediator in private sessions is to record **only** the information that the party I am meeting with authorises me to disclose to the other party (if any) . Having to record everything he or she is told in a private session will make it harder for the mediator to be an active listener and may make the party imparting the information nervous as they see all their secrets recorded.
- 33.8 Further, it would make me nervous as a mediator to have to go into private session with Party B carrying with me my notes of all the confidential information just given to me by Party A.
- 34 It seems likely that the possibility of disclosure by the mediator before arbitrating will lead to parties disclosing less to the mediator in private session than in a conventional mediation. That may have the result that the mediation part of a med-arb process may be less effective than a conventional mediation.
- 35 As a result, lawyers should advise their clients whether the likely savings in costs and time of a med-arb process outweigh the possible loss in effectiveness of the mediation portion of the process. This will not be easy advice to give.
- 36 Despite these problems, s. 27D(7) is a very constructive attempt to solve the second law of natural justice problem that med-arb creates.

The potential

- 37 Section 27D makes med-arb more workable and thus adds another tool to the ADR practitioner's toolkit. All dispute resolution lawyers should be aware of its potential to save their clients time and costs.

38 Only time will tell whether s. 27D will encourage parties in dispute to use med-arb in significant numbers.

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