Avoiding the “Boomerang”
Resolving Disputes Before They Ruin the Deal

by Frank Aquila & Kathy Bryan

The scenario is all too familiar. The deal is done, the contract is signed, and no sooner than the ink is dry, the fighting starts.

Disagreements begin innocently enough. A simple misunderstanding starts with little more than a few testy emails. Tensions escalate. Meetings are called, but nothing is resolved. Both sides bring in their litigators. Everything begins to dissolve, except of course, for the costs of litigation.

Though, executive time and money are all squandered in making a decision to file suit. It takes away from other, more productive, activities. If executives agree that litigation is a bad thing for business, and the last resort to solve major issues, then why do so many disputes end up in court?

Isn’t this foreseeable? Or is it just our litigious culture?

Or is it something more fundamental?

Of course it’s foreseeable. Of course we’re litigious.

Conflict happens.

But it really is something more fundamental: A dispute that could have been anticipated and properly addressed in the contract was not addressed or pushed to the side. Oh, sure, a disputes clause may be present, and it may even require executives to meet to discuss the issue before resorting to the court. But, that time-honored approach—which we fully support and endorse—often becomes part of the boilerplate, little more than a pro forma approach to a potentially significant problem.

It’s just one more step toward a result—not a resolution, but an ending—that will come about, somehow, after an expensive and time-consuming battle.

If the parties recognized that serious disputes could be identified as a part of the deal making process, they could effectively avert suits in most, if not all cases. Why not use tools that have proven to do just that?

Everyone wants their deal signed, right now. Once signed, then the focus turns to Closing. But a lack of understanding, information about effective conflict resolution methods, and a reluctance to spend negotiating capital on these “back-burner” issues that contribute most frequently to using the standard and often ineffective ad hoc approaches.
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It’s time to change that.

Instead dealmakers can adopt appropriate, tested and effective de-escalation techniques and build them into the contract. Having a defined process promptly channels effort on both sides into constructive solutions and reduces the likelihood that the issues will ripen into lawsuits or more importantly, that the deal simply blows up. It’s pretty basic, but it is done all too rarely.

Dealmakers and their lawyers appropriately focus on significant risks and allocation of liability during negotiations. Worst-case scenarios are projected and solutions anticipated. It’s all part of the negotiation process. But the adjustments shouldn’t just appear in the numbers. The parties should acknowledge that those scenarios occur, regularly, and build in processes—we’re talking about a reference here, not reinventing the judicial system—that will close the deal both effectively and quickly.

No two deals are the same and each and every transaction will have unique issues, but in the same way as we craft unique provisions to deal with tax or regulatory concerns, we should also be negotiating provisions that will induce the parties to resolve disputes before, during and following the Closing. Crucial improvements using the four techniques described below could be included easily in deal discussions, without sacrificing negotiating leverage.

1. Design Contractual Incentives to Cooperate

Deals combine businesses, but deals also merge cultures. The subsequent stresses and strains of melding those cultures can create increased opportunity for communication challenges and misunderstandings. Studies of ten show that transactions most often “fail” because of poor post-Closing integration. To counter this, the parties should attempt to create a new culture that anticipates and prevents disputes. The ideal time to start is during the deal design phase.

Changing culture is more easily achieved when financial incentives are aligned. In addition to other more standard integration techniques, consider an incentive system or “bonus pool” based on cooperation and achievement of particular stated goals and timetables. While this approach takes more upfront work in defining specific goals, the benefits include reducing the potential for conflict and encouraging teamwork.

A bonus structure could, for example, provide cash to team members when disagreements and claims are resolved before resorting to litigation, arbitration or even mediation. Incentives payable only when all participants avoid conflict tend to subordinate individual interests to the legitimate needs and success of the organization as a whole. These bonuses could be structured separately or included as one element of an overall bonus system.

Another technique encourages early problem identification by identifying specific champions who are trained in conflict identification. These individuals become de facto ombudsman who are skilled in conflict resolution techniques such as encouraging brainstorming, listening, reframing and a host of other tools to help individuals and teams ferret out problems at the earliest possible stage and direct the issue to productive problem solving.

Anticipatory programs are not new, they are just woefully underused. They also have centered on specific industries and practices—understandable, but not an explanation why they haven’t permeated deal work generally.

For example, in the healthcare field one innovative program requires parties to “recognize, respond and resolve” before a claim can be made. Direct communication, apology, explanation and correction are important tools when personal injury and/or property damage are identifiable risks.

Large-scale construction projects have led the way with voluntary partnering, which develops strategic alliances that endure during the long-term contracting process. The partnering culture is created from the beginning of the project. It starts with a retreat or workshop among leaders and managers, generally with the help of an independent facilitator.

The focus of the retreat is to express objectives, expectations and common goals, initiate open communication and establish non-adversarial processes for resolving potential problems. Periodic follow-up evaluations and meetings continue the culture of partnering throughout the project.

Essentially, a partnering process delivers the message to the entire organization that time spent understanding each others’ perspectives and effective communication are vital to the success of the deal and deserve high priority and allocation of time and resources from the outset.

The U.S. Air Force has been a pioneer in the area. More than a decade ago, the commandant of its Defense Systems Management College, which trains senior military procurement officials

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in negotiating big-ticket defense contracts, told a meeting of the CPR Institute defense contractors in New York that there is no perfect agreement.

“Where you have a complex contract, you need to build in enough flexibility so you can deal with those things that you don’t know the day you write the contract,” he said, noting that conflict resolution techniques acknowledge that “there may be issues that we have to deal with. It improves long-term partnering.”

He concluded, “We’re moving to get the legal and the business community together so that we view this as a team approach”

Sitting just down the dais and agreeing whole-heartedly was the Air Force official’s private counterpart, a contracts vice president of Boeing Co. Boeing, he said, had 10,000 active contracts, and litigation avoidance was a top priority.

The key, the panelist/contracting partners agreed, was to start at the at the point of contract formation. Said the Boeing official, “How are we going to solve issues? What are the risk areas? What are the challenges that we’re going to have in completing this contract?” See “Special Supplement: Winter Meeting, April 2000,” 18 Alternatives to the High Cost of Litigation 67 (April 2000).

Those conflict resolvers have continued to practice what they preached. Such partnering arrangements are now a part of the basic defense contracting culture. Any given Air Force base will have dozens of such partnering contracts in effect at a given time, on everything from maintenance to aircraft construction. See, e.g., “Partnering for Better Support,” Military Logistics Forum, Vol. 4, Issue No. 1 (February 2010) (available at http://www.geospatial-intelligence-forum.com/mlf-archives/226-mlf-2010-volume-4-issue-1-february/2529-partnering-for-better-support.html).

2. Allocate Risk Fairly

Risk allocation is synonymous with deal negotiation. Dealmakers are charged with getting the best deal possible for their organization. But if the resulting contract provisions unrealistically allocate risk to one side, the potential for disputes increases significantly. In short, misallocation of risk promotes subsequent disputes.

To avoid such misallocation, international food products giant Nestle deploys mediation as a business tool to help iron out issues in complex negotiations for joint ventures and the company’s alliances. “In mergers and acquisitions, Nestle will send complicated liability issues to a mediator ‘in a fast-track procedure’ so the transaction doesn’t get hung up. “Highlights from Vienna: CPR’s Fourth Annual European Business Mediation Congress,” 26 Alternatives to the High Cost of Litigation 142 (July-August 2008).

Paying close attention to fairly balanced risk provisions pays dividends in the long term success of the venture.

3. Use Step Negotiation . . . Effectively

Deal negotiators are generally familiar with a “step clause” that requires managers to negotiate first, and, failing resolution, employ a series of escalating steps to either the courthouse or selection of an arbitral tribunal. But this may not create enough incentive on the business managers to fix the problem.

The technique, and its effectiveness, centers on authority. The person doing the negotiating needs to be able to agree on behalf of the deal party. If he or she can’t or won’t, the talks need to escalate. The presence of the escalation encourages managers to work even harder to find innovative solutions before the matter goes above them—or worse, to separate legal camps.

For example, when managers are unable to fix the problem, require the CEOs or Chairmen to meet before the matter goes down the legal path. This creates tremendous pressure on lower levels of management to solve the problem.

Too often, the parties point to the deal boilerplate and relegate the issues to the legal team. Typically, dealmakers have assumed that their lawyers are better skilled and equipped to decide the right dispute resolution mechanism. The litigation lawyers are usually consulted late in the process to design a clause.

While deal negotiations will focus on the legal/technical details like choice of law, situs, and arbitral rules, on the purposes of the negotiations are the deal’s real terms. The negotiators, not the lawyers, know those terms best and should address them not only at the bargaining table that strikes the deal, but when and where there is fallout later.

4. Use Third-Party Resolvers When Appropriate

The construction industry has used an extraordinarily successful approach to keep projects moving while simultaneously resolving complex disputes through the use of “standing neutrals.” A standing neutral is a “trusted neutral expert selected by the parties at the beginning of their contracting relationship to be readily available throughout the life of the relationship to assist in the prompt resolution of any disputes. The primary objective in appointing a standing neu-
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tral is to get disputes resolved economically at the earliest possible time, while facts are fresh, so that the parties can continue with their business relationship.”

Construction is way out ahead on this too. General Contractors cannot afford to halt work when there is a fight with a sub. Problems are completely foreseeable even if the specifics of the problems aren’t. The industry has become comfortable partnering to resolving disputes.

But the standing neutral is even better. Experts in the field say that the mere presence of the standing neutral on a project will halt disputes before they invoke the need to use the neutral. Experience in the construction industry has shown that the availability of the neutral has a tendency to encourage the parties to be more fair and willing to work cooperatively, with fewer disputes rising to the level requiring neutral involvement.

The parties will take it upon themselves, and “escalate” the importance of the talks. Parties anticipate the neutral’s decision, and as a result tend to use fewer hardball tactics. The parties aren’t just avoiding the dispute—the presence of the machinery of resolution encourages the prevention that the partnering and contract drafting may have missed when deadlines are missed and materials remain undelivered.

Identifying one or more trusted neutral parties to be available throughout the integration phase has many benefits and can be structured flexibly to meet specific business needs. One or a panel of neutrals can be identified depending on types of technical expertise needed. This approach could be particularly effective in resolving disputes that arise in joint ventures and strategic alliances.

It is critical that the neutral be selected with care and have the trust of the parties. Depending on the circumstances, the contract can specify whether the neutral should be more deeply involved in the business or simply on standby when called up to resolve disputes. Similarly, the contract can define the neutral’s role as nonbinding (standing mediator) or binding (standing adjudicator).

And in spring 2001, a dozen business conflict resolution experts debated in an online seminar hosted by the CPR Institute the application of and best practices for transactional mediation and deal ADR. See “CPR’s Online Seminar: Transactional ADR, May 2001,” 19 Alternatives to the High Cost of Litigation, 173 (July-August 2001). The panel analyzed the minutiae of getting processes into clauses at the outset in order to provide the means to make the efforts, and the deal itself, function. But the acknowledged point of the discussion was dispute prevention.

Final Thoughts

Disagreements are endemic to most relationships. Mergers, acquisitions, joint ventures and strategic alliances are no different. When things veer off their intended course, the question quickly goes from “is there a deal?” to whether the dispute can be resolved. While each and every deal is unique and requires thoughtful solutions, the solutions to resolving possible disputes should be equally unique and thoughtful. Getting to signing, and then the Closing, must be the primary focus of all experienced dealmakers. Considering disputes that may occur out in the future may seem less important in the midst of a long negotiation, but in the long run, time spent considering possible disputes and how to resolve them will ultimately prove to be time well spent indeed.

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