Negotiations, mediation, litigation or arbitration: what to take into account when selecting the most efficient procedure for dispute resolution?

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In modern world, an important trend promoting ethical business practice is for civil society to regulate itself when resolving legal disputes. The increased burden on the courts and a growing number of business entities and disputes between them have resulted in increased attention to different types of dispute resolution procedures. It would be helpful to highlight certain advantages and disadvantages of the relevant method for resolving a dispute in the economic field, as this may help to choose the method that is the most efficient in a specific situation.

Before the Russian Arbitration Procedure Code (the “APC”) entered into force in 2002, the Russian legal system only provided for two types of dispute resolution procedure: negotiation or arbitration. The APC provided an option for the parties to file a petition to postpone the proceedings if the parties had turned to a mediator to resolve their dispute. However, only after Federal Law No. 193-FZ On alternative procedure for resolving disputes with an intermediary (mediation procedure) (the “Mediation Law”) dated 27 July 2010 entered into force did it become genuinely possible to talk about a new dispute resolution method that had appeared in the Russian legal system.

When we compared different methods of dispute resolution, we used the following criteria to evaluate their efficiency:

- whether the procedure is easily available and sufficiently regulated;
- whether the parties to the dispute must comply with the provision regarding the procedure in question;
- timelines for settling the conflict;
- confidentiality;
- costs of the procedure.

Whether the procedure is easily available and sufficiently regulated

In our opinion, negotiations as a dispute resolution procedure are the basis without which it is impossible for the parties to reach understanding in the form of a mediated or settlement agreement. In this regard, it is especially important to receive support from professional advisers and attorneys who will not only conduct an independent examination and evaluate the legal position of each party, but will also help move negotiations forward. Often, this sort of examination helps to prevent unjustified claims being filed with the court or serves as a basis for starting negotiations. Practice shows that a dispute may be prevented or regulated when an independent legal examination is conducted. To this end, we recommend that a legal opinion be prepared regarding the existing and potential risks before a decision is taken as to the method to choose to resolve the dispute. This could be done either at the stage when the legal relationship of the parties is formed and implemented (when the contract is drafted or the ongoing activity is performed) or after the dispute arises.
In many cases, the party that believes that its rights have been violated files a claim with the court without as much as an attempt to start negotiations or submit a complaint to the other party. Meanwhile, in many cases when the case is being considered by the court the parties find out that, to settle their dispute, it would have sufficed to submit additional documents to each other or to reconcile their settlements. That is why in many cases we recommend incorporating in your agreements a provision that would make it compulsory to follow a procedure to settle disputes out of court through making complaints to one another.

However, this dispute resolution procedure in the form of negotiations, though simple at first sight, has some disadvantages: often the parties lack communication skills and professional knowledge in the relevant sphere of legal relations.

A mediator is presumed to have these skills and also to know certain methods for settling conflicts. However, this presumption is not confirmed by any guarantees in legal regulations, which cannot ensure efficiency and does not make mediation as an institution more trusted. Therefore, it is extremely important, when resorting to mediation, to make sure that the potential mediator has appropriate professional skills. This may be confirmed, among other things, by a certificate issued according to state standards by an educational institution respected on the market of professional services.

If we compare the procedure for settling disputes through arbitration and mediation, the following should be pointed out. There are two main types of commercial arbitration: permanent or institutional arbitration tribunals and ad hoc arbitration tribunals created to hear a specific case.

Institutional arbitration tribunals such as International Commercial Arbitration Court or the Marine Arbitration Commission under the Russian Chamber of Commerce and Industry have a specific location and their own rules, while ad hoc arbitration tribunals are created by the parties themselves only to consider a specific dispute. The place of ad hoc arbitration is set out in an agreement between the parties or is determined by the arbitration tribunal. The arbitration procedure, according to general rules, is also stipulated by the parties.

The mediation procedure is also not strictly regulated and in this respect it is similar to ad hoc arbitration. According to article 11 of the Mediation Law, the mediation procedure should be set out in the relevant agreement, including by referring to the rules for carrying out this procedure approved by the relevant organisation engaged in mediation. This absence of laws that regulate the mediation procedure is quite in line with the principle of self-regulation that is becoming increasingly widespread in economic relationships. However, there is also a side-effect: it is very difficult for the parties of the conflict to absorb the court’s explanations about their right to engage an intermediary, including a mediator, to settle the dispute at any stage of proceedings in the state commercial courts (article 135(2) of the Arbitration Procedure Code), since neither the procedure nor the relevant terms and conditions are clear.

Therefore, as is the case with mediation, whether disputes will be resolved successfully by ad hoc arbitration depends largely on professional skills of the arbitrators undertaking this procedure.

As for the advantages of institutional arbitration, they include the terms and conditions of dispute resolution procedure, which are set out in laws and are known beforehand. When the parties of the potential conflict decide to include the relevant arbitration clause in their agreement or to sign a separate agreement, they already have some ideas about the place, procedure, arbitrators and approximate costs of this procedure.
When we speak about different procedures for settling disputes, a special focus should be placed on selecting arbitrators and mediators. In our opinion, if a dispute is regulated by commercial arbitration, the right of each party to take part, on the basis of parity, in selecting arbitrators is an important guarantee that the balance of interest will be preserved. If mediation is applied by two conflicting parties, it may be rather difficult to reach an agreement to transfer the dispute to one person (mediator) for settlement.

**Whether the provision regarding application of the relevant dispute resolution procedure is binding**

The voluntary nature of mediation is at the same time an advantage of it and a disadvantage. On the one hand, coercion to apply this procedure would be against its basic principles. On the other hand, in contrast to the arbitration clause according to which the disputes should be settled by commercial arbitration, an agreement for mediation and the mediation procedure itself does not prevent the case from being considered by a court. Therefore, it seems reasonable to take the view that it would comply with article 4(1) of the Mediation Law for the claim not to be considered by the state commercial court if the parties have agreed to apply the mediation procedure.

The arbitration clause according to which the disputes between parties should be resolved by commercial arbitration also does not prevent any of the counterparties from filing a claim with the state court. If, before the first objections are filed regarding the merits of the dispute, the defendant does not declare that it disagrees with such a departure from the arbitration clause, the case will be considered by the state court. However, the mere opportunity to make the relevant declaration is an important guarantee that the arbitration clause is binding.

*It is important to remember that irrespective of the dispute resolution procedure set out in the agreement (by filing and reviewing complaints, through arbitration or litigation), mediation can always be used if there is a conflict situation.*

**Timelines for resolving disputes**

If we compare the timelines for resolving disputes using different litigation and dispute resolution procedures, it should be noted that abroad it takes much less time as a rule for commercial disputes to be considered by arbitration than by state courts, where a case may be litigated for several years. Therefore, arbitration is an efficient alternative mechanism for resolving disputes quickly and competently.

However, as for commercial arbitration in Russia, as a rule, the state courts tend to dispose of matters more quickly.

The timelines for the mediation procedure, according to the general rule set out in the Mediation Law, are determined in the agreement about mediation. The mediator and the parties should take all reasonable measures to ensure that this procedure is completed within 60 days. The law allows the period for mediation to be extended if the dispute is complicated, or if additional information and documents are required. The maximum period must not exceed one hundred eighty days, except for the period for mediation when a dispute is transferred to a state court or arbitration tribunal (this period must not exceed sixty days).

Therefore, there are grounds to believe that a dispute may be resolved through mediation faster than it would be considered by arbitration or a state court (especially since the timelines for cases
Confidentiality

Confidentiality is one of the most important principles of mediation. Article 5 of the Mediation Law forbids the mediator to disclose information relating to the mediation procedure without consent of the parties. However, if mediation takes place after a claim has been filed with the court and if based on its results the court has approved the settlement agreement, the information about the terms and conditions of this agreement will become available to general public after the ruling that approves the settlement agreement is posted on the web site of the Supreme State Commercial Court.

Unfortunately, provisions to grant a mediator testimonial privilege were removed from the draft Mediation Law, so it is not fully guaranteed that information he/she receives from the parties to the conflict will remain confidential (for example, in contrast to information received by an attorney).

The confidentiality regime attributed to commercial arbitration (for example, § 25 of the Rules of the ICAC under the Russian Chamber of Commerce and Industry), as a rule, prohibits the disclosure of information that became known to arbitrators, reporters, experts appointed by arbitrators or court staff in connection with a dispute being resolved.

However, regulations applied to the activity of mediators and arbitrators do not prohibit the parties of the conflict from disclosing confidential information that has become known to them during dispute resolution procedures. In view of the above, we recommend including in the agreement about the dispute resolution procedure a provision prohibiting the parties from disclosing confidential information that has become known during mediation or arbitration.

Costs

Obviously, when choosing a dispute regulation procedure, great importance is attached to the costs of carrying it out.

According to article 10 of the Mediation Law, mediators perform mediation for a fee or free of charge. However, the companies that arrange mediation always act for a fee.

In many foreign countries, it is cheaper to resolve commercial disputes by arbitration, than by litigation. However, in Russia the costs of disputes being considered by commercial arbitration are, as a rule, considerably higher than the costs of litigation. The costs of arbitration depend on the amount of the claim, place of arbitration, number of arbitrators and complexity of the dispute, as well as on whether outsource experts or translators need to be engaged. However, it should be noted that many institutional arbitration tribunals provide for an expedited procedure for considering minor claims and disputes and allows conflicts to be considered by a single arbitrator in situations where the parties have not chosen differently.

Ad hoc arbitration also allows for the costs to be reduced, provided that the parties reach an agreement regarding a simplified arbitration procedure.

An analysis of information posted on web sites of companies that provide mediation services shows that the costs of this dispute resolution procedure are commensurate with or exceed the costs of the case to be considered by a state court (as a rule, the intermediary’s services are paid
based on an hourly rate or in the form of a certain percentage (typically, 5%) of the amount at dispute). However, they are lower than the costs of the dispute being considered by commercial arbitration. If no significant financial incentives are introduced for applying dispute resolution procedures or, to the contrary, if the costs of litigation do not increase, there will be no grounds for expecting mediation to become widespread.

The experience of Germany shows that even making the dispute resolution procedure compulsory does not reduce the number of cases considered by courts. Therefore, we can hardly expect the burden on the courts to reduce if the law is adopted that would make dispute resolution procedure compulsory with regard to certain types of disputes. (The Russian President instructed the Prime Minister and heads of supreme courts of Russia to draft such a law in December 2011.)

We should also point out certain tax risks associated with paying for mediation services. Since the Mediation Law does not require the mediator to have a degree in law, in many situations the mediator’s services may not be treated as legal; nor are they information services. In this regard, until the relevant amendments are made to the Russian Tax Code, in particular to article 264(1), the question remains open as to how the expenses on the mediator’s services should be treated. At present, they may only be treated as advisory or other similar services. There may also be certain difficulties in relation to trying to prove that expenses on mediation have a positive financial effect on the taxpayer’s business activity in terms of article 252(1) of the Tax Code. Primarily, this may constitute a problem for a party that has legal grounds, for example, for collecting a large amount from its counterparty, but that surrenders its claims in part or forgives the debt.

**Finality and enforcement of judgments (agreements) based on the results of dispute resolution procedures**

There are a number of advantages offered by arbitration, which can be considered as the most significant. These are finality of the arbitration award and its enforceability in Russia and abroad.

A mediation decision is executed based on principles of voluntariness and good faith (article 12(2) of the Mediation Law). If an out-of-court mediation agreement is to be concluded, the mediation procedure is performed without the dispute being transferred to the court. In this case, the mediation agreement is actually a civil transaction (article 12 of the Mediation Law). Accordingly, disputes that relate to a failure to perform this transaction should be considered by the court. Therefore, a mediation agreement reached before the dispute has been transferred to the state court or an arbitration tribunal, if not performed, will result in all advantages of the dispute resolution procedure being lost and will require additional time and financial costs from the parties. The court will determine whether this agreement complies with requirements for transactions of the relevant category (compensation for release from obligations, subrogation, forgiveness of debts, offset of a similar counterclaim, compensation for harm, etc.).

As provided for in article 12(3) of the Mediation Law, if the parties reach a mediation agreement after the dispute has been transferred to a state court or an arbitration tribunal, the court may approve this agreement as a settlement agreement. However, the fact that the mediator achieves the goal of mediation specified in article 2(3) of the Mediation Law, i.e. to resolve the dispute and to find a mutually acceptable resolution, does not guarantee that this agreement complies with requirements of effective legislation applied to settlement agreements. *In this regard, we*
recommend engaging lawyers during mediation both at the stage when suggestions are made regarding how the dispute should be regulated and when the draft agreement is prepared.

It would be reasonable to analyse foreign experience where mediation decisions are notarised and given the effect of enforcement documents. If legal guarantees were provided that the agreements reached may be enforced out of court under a simplified procedure, this would make the mediation procedure significantly more attractive.

According to practice, the majority of conflicts arising between parties of economic legal relations result from obligations being violated by only one party. Therefore, when any procedure is applied to settle a conflict, one of the parties will have to give up its interests to a greater extent. However, the public nature of state courts creates a certain psychological barrier for the party that was ‘at fault’ for creating the conflict situation and makes it difficult for it to acknowledge the claim or to start resolving the dispute by signing a settlement agreement.

In this regard, an important advantage of having the dispute resolved thought arbitration or mediation is that it is possible to avoid having information published. This information can negatively affect the party’s business reputation as it will become known that property claims or other claims have been raised against this party and that it has obligations that it failed to perform.

**In conclusion, we would underline the importance of mediation as a method for resolving disputes promptly and to maintain a partner relationship through resolution of the conflict and after it is resolved. We also stress that, according to the general rule, it is only reasonable to initiate court proceedings in a dispute after other dispute resolution procedures have been exhausted.**