

Pro-Active Mediation of International Business & Investment Disputes Involving Long-Term Contracts: from Zero-Sum Litigation to Efficient Dispute Management*

By Thomas W. Wälde, Professor of International Economic, Energy & Natural Resources Law; Jean-Monnet Chair for EU Economic & Energy Law; Principal, TWA International Mediation Services; Chief Editor, Oil, Gas & Energy Law Intelligence

Third-party assistance and support to help parties in a dispute to reach a mutually acceptable settlement is recognised in many types of disputes: family and labour disputes, but increasingly also in commercial disputes. Modern court reforms encourage and sometimes require mediation; often, evidence of satisfactory collaboration in court-ordered mediation has a bearing on the decision on the costs of subsequent litigation. In several legal systems, there is now a positive, enforceable duty to make best efforts in mediation. All statistics point to a significant and continuing increase in the solution of disputes by mediation (conciliation) rather than by conventional litigation. But this is not so in international commercial and investment disputes. While there have been notable conciliation projects in international law (Beagle Channel dispute between Argentina-Chile; Guatemala-Belize border dispute), there is little evidence of systematic, professionally applied mediation in disputes between parties from different countries. These disputes seem to be solved either by bilateral negotiation or, if such efforts fail, by litigation before courts or, primarily now, before arbitral tribunals. This note – summary of a larger and on-going study¹ – highlights the key concepts behind mediation and reviews three – sanitised – case scenarios for illustration.

Litigation – arbitral or judicial – is as a rule and contrary to many claims in the past very costly, takes a very long time, can lead to contradictory results. It is not finished with the judgement/award since the losing party will often battle for many years to come against enforcement. All litigation methods tend to undermine, and mostly destroy, an existing commercial relationship and thus sig-

nificant asset value: Building international commercial and investment relationships is a high-risk, expensive and therefore, if successful, very valuable asset building activity in itself. Litigation therefore frequently acts as a destroyer of high value. Litigation methods are also very costly: Up to 10 or more specialised lawyers are paid by both parties (in addition to their own staff) to “learn” about the case, while the litigation constraints and attitude makes such learning very difficult. Each party tends to present information in highly selective and often contradictory ways so that the “learning” by the tribunal is not only extremely costly, but very difficult. Few commercial relationships can survive a full-blown litigation, arbitral or judicial. While arbitration in the distant past was often seen as “political arbitration”, i.e. involving an element of settlement and of quiet diplomacy, modern arbitration has come to resemble large-scale (and now often public) litigation. The vested interests of most actors involved point towards fighting a case to its very end (and beyond). The concern of arbitral tribunals over future appointments, challenges, setting-aside procedures and other post-award attack opportunities make them reluctant not to exhaust rules and procedures to the very fullest at whatever the cost. Some large-scale modern investment arbitrations – both under the NAFTA and bilateral investment treaties – are known to have cost tens of millions of US\$ in total and taken over 4 years to fight to the bitter end. Many business clients have told us that the initial estimates provided

* Published in OGEL 4 (2003) at www.gasandoil.com/ogel

¹ There is an on-going research project involving economic analysis of the alternative forms of international dispute settlement in oil, gas, energy, mining, infrastructure and investment disputes at CEPMLP, led by this author.

for litigation (and on which the litigation decision was taken) are often by multiples lower than the final result. In other words: Massive cost-overruns are rather the rule than the exception. Going to litigation (before arbitral tribunals or courts) therefore mostly indicates some form of management failure.

Although long-term contracts establish the legal basis for a revenue stream that is used to finance capital investments, long-term contracts may give buyer and seller a false sense of comfort and security by allowing them to lose sight of the fundamentals of their business. This is not healthy, from a business perspective. When technological and political changes render the original forecasts and assumptions obsolete, or when there is a dramatic change in the management or ownership structure of one party, it may be better for both sides to re-negotiate the contract rather than try to enforce the prices, terms, and conditions in the original contract. To invoke the “sanctity of contract” is sometimes a naïve business strategy, although it is always a viable legal argument.

Can mediation therefore be a practical alternative for international business disputes, much as it has become in the domestic management of disputes? One needs first to appreciate the difference of mediation to arbitral/judicial litigation: Mediation involves an independent third-party (the mediator(s) and the mediation team), but the mediator does not make a legally binding determination of the issues at dispute, but works with both parties to move them towards an agreed settlement they both can live with and which both consider is better than the prospect of protracted, very costly, uncertain and relationship destroying litigation. For the parties, the key understanding is much less what is right and wrong in the sense of judicial determination though perceptions of right and wrong, as a rule biased, the original contracts and the shadow of possible arbitration all play their role in the negotiations. Their key interest is rather in a new approach to creating value and prolonging an otherwise worthwhile relationship is what makes mediation a powerful tool. All the opportunities – but also some of the constraints – of mediation derive from this essential difference.

Arbitrators “sit” – they wait for evidence and argument being presented to them in a highly ritualised way by a select group of lawyers appointed by each party in a formal process. As Mediator, I do the opposite: I go

to the parties, I penetrate deeply into the parties’ internal organisation, culture, values, prejudices and in complex cases into difficult relations with external, but affiliated, involved, affected or influential players: subsidiaries, parent companies, suppliers, purchasers, government agencies, financial institutions and, in particular in the energy field, regulators.² The amount of information and insight obtained – as a rule voluntarily provided by the parties (though such provision needs to be worked on and can be like extraction of teeth) – tends to be therefore much more comprehensive and cover many more facts and facets (intra-organisational rivalries and corporate politics, personal sentiments and cultural, national and ethnic prejudices) than the exchange of statement of claim, statement of defense, rejoinder and cross-examination in international arbitration. While there is as a rule an initial reluctance to talk freely, such reluctance tends to overcome by a skilful mediator. The mediator is not – like arbitrators/judges – given slanted information selected for its suitability to win a particular set of legal arguments – but is informed much more freely and without the strategic bias required in litigation. To learn about the dispute by litigation is like a course with many hurdles – nobody wants you to learn what really happened. In mediation, the parties will become quite keen to provide as much information and insight as possible – not to 10 lawyers, but to the one or two mediators. Technical experts can be used much more freely, in a less constrained and stilted way, to develop a collegial relationship with the experts from both parties.

A systematic approach in mediation can take some useful elements from litigation. For example, I tend to adopt the procedure of requesting a written submission of a party’s narrative of the history between the parties and of the key documents, response to questionnaires to mediation as appropriate. I want to go through as much as possible through the files – on both sides – on the negotiations. I realise this is usually only the tip of the iceberg, but it helps to feel for hidden blockages, perceptions and at least the formal, organisational view of the dispute that has developed within the organisation itself. I tend to write formal assessments of each party’s legal, commercial and financial position – but only for discussion with each party. I also develop with the parties a “Joint History Narrative” to bring the always exaggerated, biased and to a considerably extent factually incorrect perceptions with the organisa-

² In energy, regulators may mean both national regulators – including their own often not easy relationship with each other, but also supranational regulators such as the EU Commission.

tion of each party towards a greater level of realism – necessary to start a rational analysis of the strengths, weaknesses and opportunities present with each party.

The mediator's skill is not in deciding what is right under applicable law and proven evidence, but rather what kind of renegotiated deal the parties can accept, and prefer to the always present option to go to litigation. The consequence of this radically different approach is that a proper mediator will pro-actively seek to identify the causes for the dispute, the blockages hindering the parties from settling by direct negotiations and possibilities for a new deal. The deal can be a "velvet divorce", i.e. a peaceful liquidation of their relationship. But given the significant value of international commercial relationships, the aim will always be to set up a renegotiated system of contracts, of institutional procedures between the parties and perhaps even a continuously available facilitation mechanism to help the parties to a win-win situation under altered economic, regulatory and renegotiated contract conditions. The mediation process is therefore not "normative" and ex-ante in the sense of applying pre-existing rules ending a relationship, but rather creative and forward-looking in order to unlock value out of the – renegotiated – relationship. It is for these reasons that the traditional litigation skills which focus on skilful selection of facts, of squeezing the maximum effect out of the other party's inevitable imperfections and of an antagonising – we versus them – approach are utterly inappropriate for a mediation job.

It is perhaps useful to give specific examples from my own practice to give the reader a concrete idea what mediation is about.

1) State-Investor long-Term Mineral Investment Dispute

A mineral producing country had lived with mineral extractions for over 20 years without any meaningful tax revenue from the operation. Pressure for cash, and a sudden price spike, pushed it to stop any export to extract new royalties contrary to a tax stabilisation clause. The company did not want to yield, also to avoid setting a precedent. It could have initiated political pressure based on host state protection and the involvement of many financiers. But it desperately wanted to profit as much as possible from the – temporary – price spike. Negotiations had gone

into dead-lock. Litigation did not promise any rapid way out. A deal facilitation team was put together, funded by an international agency. It applied know how and expertise from the Harvard Negotiating Group in addition to technical, legal and financial skills. The team's experts identified that a – very difficult – government expert was both key and chief impediment to a solution. It managed to maximise recognition to this expert and turn him from an obstacle to a promoter of a renegotiated deal. The application of rational analysis to the situation of both parties demonstrated that a rapid settlement was in everybody's financial and political interest, that triggering outside intervention and litigation would lose a temporary valuable opportunity, bring in actors with a vested interest in continuation of the dispute, destroy the 20-years relationship between both parties and damage their reputation. A deal was struck that satisfied the investor, while generating a rapid inflow of close to 1 billion US\$ to the government.

2) Two Oil Companies in Dispute over the Bank Guarantee Posting Obligation in a Joint Operating Agreement

Two oil companies had a dispute over financial obligations related to bank guarantee posting out of an on-going joint operating agreement. The language was not absolutely clear though trade practice favoured the position of one company. Previous practice in the relationship may have favoured the other. The dispute was handed over on both sides to the legal department. The lawyers handling the case thought that arbitrating it would cost a lot of money – an estimate might have been 500 000 \$, take a lot of time, and make future interaction on this and other projects more difficult. But they could not settle the dispute directly as giving in on the company's fundamental position would be seen as disloyal to the two country general managers. They appointed a mediator with the task of making a recommendation and, in case of failure of the two companies to agree, to make a binding determination. It took 2.5 days to understand the issue, review the legal documents, get an idea of trade practice, but also, in two telephone interviews, to find out what both parties wanted: One wanted to avoid a precedent for its global operations, the other wanted to avoid a financial obligation counted against its capital. With some brain-storming, the non-zero sum solution emerged: One party assumed the financial

obligation for the next period, the other one conceded that the other party was right in its interpretation of the contract. Within days both parties agreed – very satisfied that the dispute was settled so expeditiously, and even gave to each party what they valued most.

3) Two Large Energy Companies Use Mediation to completely Restructure a Long-Term Contractual Package for a Large Joint Investment

Two very large energy companies had built a joint facility together, based on a long-term power purchase agreement. Economic, regulatory and political circumstances changed dramatically, and probably beyond the expectations of all or most people involved. The joint facility's exclusive contractual use was seen as extremely onerous by one party, while the other one insisted on proper fulfilment of its 20 year PPA to recover investment and planned return. The parties had negotiated for 3 years, without coming during several renegotiation efforts to a new deal. Arbitration loomed and arbitration specialists were circling the dispute. The value of the dispute might have approached 1 billion US \$. Arbitration costs were estimated at several M US\$, time for an award in about 3 years with enforcement proceedings dealing with public-policy issues adding another 5+ years. There were several other companies – transporters, traders, suppliers – and three, rapidly moving and disjointed regulatory regimes to be taken into account.

Both parties came so far as to agree on appointing a mediator. The constructive and facilitative role of the external legal counsel of one of the parties was crucial, both for reaching the mediation agreement and for seeing the mediation process through. A mediator was chosen by public tender, with the shortlist made up of internationally leading financial, accounting, management consulting and engineering companies, each with a proposed "Sole Mediator" to manage the process. The mediation revealed that for each party the challenge was to develop a realistic understanding free from multiple personal, institutional and cultural biases and misperceptions. In the beginning, the parties were barely able to mention that there was a dispute. With gradually added pressure for information, and direct interviews of the mediator with the top management, senior executives and experts in both parties and other relevant players, more and more information

came out. Internal divisions showed up. The Mediator facilitated a significantly improved understanding in both parties of the legal and regulatory environment and of changes to come in the near future. This created greater weight for a perception that an arbitrated solution based on the then-existing contractual framework might not have longevity, and certainly would do nothing to fully develop the synergies for optimising the potential of the joint facility. The mediator here both helped to change the valuation, in particular with respect to risk, of the arbitration option (the zero-sum option) in the prospective claimant's eyes, but also to make the risk of that option weigh fully in the prospective defendant's eyes. He then proceeded to identify and to develop the greater attraction of a cooperative, non-zero-sum alternative for both parties.

A – confidential – assessment of each party's position was presented and discussed within each party, an action that shook the pre-existing self-confidence about being right, smart and more competent than the other party. The organisational dynamics mean that it is almost impossible for a realistic assessment of a dispute to develop within the organisation. A distorted view is not an exception, but the normal result of the way a dispute with an outside organisation is processed, perceived and managed within the organisation. A joint history gradually evolved – and was formalised – which gave to both parties together a much more realistic view of the situation. An in-depth review of the negotiating files and direct interviews with major players within and outwith the companies indicated that the joint facility could be turned around into a trading venture with considerable profit opportunities if the contractual, corporate-institutional and regulatory regime for the facility were modified. This allowed to use the expected joint facility profit to be used to repay a substantial part of the original investment.

The parties had been close several times to striking a deal, but the cultural differences between both had created too many blockages. It is essential here for a competent mediator not to get lost in details, in particular related to sub-issues of one's specialty (which I suspect most professionals involved in a dispute tend to do by taking a technically very professional look at each tree, but without an eye to the forest), but to home in on the essentials – people, issues, potentials, constraints, perceptions, solutions – of the conflict. A dispute-specialised communication scientist helped to identify some of the personal block-

ages involved. With CEO support from both sides, a supervised and facilitated 3-day mediation meeting was arranged at a suitable and neutral location with a suitable negotiation team on both sides, prepared by several shuttle-missions, technical assessments and an overall scheme proposed. The rules of the game, the name of the players and the joint target to work for were all prepared beforehand, and much negotiations between the mediator and the parties.

During this mediation session, the role of the mediator and his support team waned to the extent the main negotiators were able to collaborate effectively with, rather than against each other. The mediator started as chairman, mutually trusted confidant and overall architect of the mediation process and the mediation proposals being presented, but ended as a sympathetic observer on the sidelines. The reason was that the mediation process had worked: To facilitate and help the parties to cooperate with each other effectively. An agreement on principles was reached. The interpersonal and inter-corporate dynamics released by the meeting and some – limited – mediation support helped both parties to reach a formal, ratified agreement within 6 months of the starting date of the mediation contract. One should add that the senior negotiators were promoted and acquired additional responsibilities subsequent to the mediation. The mediation, thus, paid off for them personally. Litigative approaches with their considerable risk of losing both case and face are, on the other hand, a much more high-risk game for a corporate executive: If they win, the lawyers will go for the credit, if they lose, the executive in charge has to pay: Both for having gone for litigation and for having chosen the apparently wrong strategy and counsel.

These three examples illustrate various facets of – successful – mediation, partly on a very large scale, in international business. They confirm some findings from literature according to which mediation cost and time could be around 15-25% of full-blown arbitral litigation. The most important benefit – escaping from the chains of the zero-sum culture of litigation – is harder to quantify but should count more in most cases.

There are some conditions which must be met for mediation to work:

! First, the two parties – or someone sufficiently influential in both parties – must be seriously interested in a facilitated and externally managed renegotiation rather than litigation. It is not that

important that such interest may not be shared by all of his colleagues or may be partly only a pretense to show good will: The mediation process per se can develop a strong self-propelled dynamic of its own. In complex and difficult mediations involving both an arbitrable dispute and the prospect of a successful and radical restructuring of a relationship I have found that a relationship with the top level of a company (CEO, board-level directors) is necessary, if only to set the intra-organisational dynamics of mediated renegotiation in motion.

! Second, the parties must be ready to ratify a sensible deal. I suspect that the reason mediation is so far not used in the many investment disputes going to litigation is that governmental bureaucracies and politicians need a far-away third-party to take the political responsibility – and scape-goat role – for a result. International tribunals and courts can fulfil this role very well. If a state would be seen as agreeing to a mediated settlement, the scapegoat function may look for a victim. But some international mediations (Beagle Channel; Guatemala-Belize) show that mediation with considerable transparency, particularly when the results are being explained, and with at least informal listening to all relevant players, can let politicians benefit from mediation. This is where more investigation is needed: How to make a mediated result – which is as a rule superior to a litigated result – politically attractive and persuasive. I am grateful to Prof Dieter Flader of Berlin – an inter-cultural communications specialist – for pointing out to me that the same methods used for inter-party mediation described earlier will work for bringing significant outside players into the mediation camp: Analyzing (“penetrating”) the internal politics, culture, values, interests and (mis-)perceptions of the main players in the ratification process and fitting a mediated solution (both in substance and in presentation) to the requirements of the internal forces of the key actors. By explaining this, one would help a governmental bureaucracy, political parties, a nationalist press, independent regulators and government agencies to convert the result of a mediation into a symbol of its own achievement – and to declare this success in public as their success. The need to look for a negative scapegoat can therefore be replaced if a positive political and emotional credit for the success can be established. This must be done carefully and diplo-

matically so that the other parties to the dispute and their sensitivities do not get provoked.

! Third: The focus of the key participants has to be resolution of a business dispute in a commercially and managerially efficient way, and often the maintenance and restructuring of a commercial relationship, rather than complete liquidation and the search for an authoritative judicial ruling on a precedential point of law. If the internal power struggle favours the legal-litigative approach, this can be a sign that the company suffers from managerial paralysis. A company that gets easily involved in litigation suffers from managerial failure, lack of ability to project sustained pro-active initiative and is itself not well able to cope with the negotiating and relationship-building demands of international business. Given the very time- and attention-consuming requirements of arbitral litigation, companies which prefer to litigate must be suffering from executive over-staffing: Idleness provides much time for and opportunities for making mischief, and litigation-friendly executives clearly have too much time on their hands. Such a company's top management and overall managerial culture does not inspire much confidence, nor for business partners nor for investors.

Mediation in international business and investment disputes can and should always look for a solution that is superior to the situation at the beginning, and often superior to the situation at the end of litigation. All disputes I have managed have so far managed to throw up creatively found optimal solutions. But even if such a non-zero sum solution could not be identified (and I have not met a case yet), mediation should be superior to litigation for simply defining the terms of a "velvet divorce".

Mediation is not primarily a lawyer's business. This is perhaps why comparative assessments between meditative and litigative approaches

do not really attract much sympathy from the part of the legal profession specialising in litigation. It requires a very exten-

sive understanding of the main players, their context and the issues, followed by an energetic, perseverant and very focused management of the facilitated renegotiation process. These skills are probably more available with commercial lawyers, executives or financial advisers and consultants with an extensive negotiation experience at senior level than with litigators in thrall to a combative, confrontational and black-and-white approach to disputes. But, as my experience indicates, there is considerable potential for legal services of a constructive kind to support the deal-preparation and deal-making activities that are at the core of mediation. In essence, it is rather a commercial function – requiring substantial commercial judgement and decision-making power – than a black-letter law or litigation function.

Where should businesses look for mediators and what criteria should they use in the selection and negotiation of the mediation terms? As everywhere, the Number One criterium is a successful track record ascertainable by consultation of previous – satisfied – clients. Formal training is only available in rudimentary form, and almost not at all for international complex business and investment dispute management.³ Most of such training is for court-ordered mediation pre-litigation. It is certainly necessary for a mediator to be familiar with the main concepts and methodology, but no amount of training can replace successful, ascertainable hands-on practice. The subject matter and industry also play a role. Familiarity – and reputational credibility – within an industry are helpful, if only to accelerate the process of familiarisation with the issues and people. Cross-border and cross-cultural disputes evidently require a well established and substantiated cross-cultural background and sensitivity. There are now many mediation and conciliation rules around.⁴ However, while they all seem eminently sensible in a very general way, they do little more than define in general terms the outer boundaries of professional ethics for a competent mediator. The proper approach will therefore have to be worked out in discussions between mediator and the two (or more) parties in light of the characteristics and context of the particular dispute. □

³ We have, though, at CEPMLP/Dundee started a professional training seminar series which is likely to be developed.

⁴ For a comprehensive survey see OGEL 2 (2003) at www.gasandoil.com/ogel