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ARBITRATION

How Fund Managers Can Mitigate the Impact of Litigation on Their Transactions and Relationships

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Investment managers do not want their transactions and relationships undermined by litigation. Litigation is expensive; diverts personnel resources; and for investment management firms looking to be perceived as good partners, presents considerable reputational risk regardless of whether a case is won or lost. Ultimately, it is a cost and drag on deals, operations and investor relations that, even when successful, too often results in a victory that is Pyrrhic at best. Fund managers are in the business of investing assets, and litigation rarely adds value to their enterprises or advances their objectives. The reality, however, is that disputes will arise in commercial transactions.

Deal documents should provide for a process to resolve the disputes that do arise in a way that minimizes their impact on the economics and objectives of the transaction. Arbitration and mediation are the two best-known alternatives to litigation, although they are often conflated by non-lawyers – and even lawyers – despite offering very different dispute resolution options, structures, processes and results. Ultimately, because the parties' deal documents can tailor and sequence the dispute resolution mechanisms to be used, parties have considerable control over how they resolve disputes.

This article discusses how fund managers can incorporate a multi-tiered dispute resolution process within their deal documents that requires parties to engage in mandatory mediation prior to submitting a dispute to litigation or arbitration, thereby mitigating the impact and risk of disputes among counterparties and salvaging or reviving valuable commercial transactions and relationships.

See "Contractual Provisions That Matter in Litigation Between a Fund Manager and an Investor" (Oct. 2, 2014).

Providing for a Multi-Tiered Dispute Resolution Process

Including multi-tiered dispute resolution provisions in transaction documentation allows for disputes to be addressed sequentially in the order and based upon timeframes set by the parties. Typically, multi-tiered dispute resolution provisions require some form of negotiation prior to the commencement of an arbitration or court proceeding. The parties have great flexibility in negotiating how that process unfolds, and courts – always pleased to limit the number of cases on their dockets

– generally enforce the parties' agreements, excluding provisions that violate public policy or are manifestly unlawful. Nevertheless, because well-drafted multi-tiered dispute resolution provisions typically do and should incorporate recognized and time-tested dispute resolution processes, enforceability of the parties' intent should not be an issue of concern.

With regard to the sequencing of the dispute resolution process, many multi-tiered dispute resolution provisions first require negotiations among the parties and then, if those negotiations fail, mediation. Only if mediation fails as well will arbitration or litigation be available forms of recourse. Fund managers are best served by proceeding directly to mediation given the benefits and efficiencies that can be gained from a structured settlement process facilitated by a skilled mediator with a neutral perspective, who works with the parties to bridge their differences.

Similarly, sophisticated counsel with experience representing clients that are fiscally oriented know that their clients' best interests most often lie in finding ways to repair frayed relationships with counterparties and avoiding the financial and reputational costs of an unnecessary, or unnecessarily protracted, dispute. Mandatory mediation processes are therefore attractive, as they force clients and counsel alike to assess and come to terms with the merits of their positions and how best to proceed in a manner consistent with the clients' economic interests.

Understanding Mediation

Litigation and arbitration are binding processes where a third party decides who wins, who loses and, as a result, where the parties will stand in relation to one another at the end of the process. The result is binary and imposed on the parties.

For more on arbitration clauses, see "HFLR Program Looks at Recent Developments and Trends in Employment Law Relevant to Fund Managers" (Jul. 26, 2018); and "Ten Key Policies Fund Managers Should Include in Their Employee Handbooks (Part Two of Three)" (May 17, 2018).

Mediation is a non-binding resolution process where the parties themselves, working with a mediator who is often a retired judge or preeminent lawyer in the relevant industry, determine how the matter be resolved and where the parties and their transaction stand at the conclusion of the process. In addition, mandatory mediation provisions allow the parties to preemptively and collaboratively craft how disputes will be mediated so as to give themselves the best chance to resolve those disputes efficiently before others – *i.e.*, judges and arbitrators – make those decisions for them, as well as to align those outcomes with their respective strategic and financial objectives.

For example, parties can set the timeframes in which a mediation must commence and conclude; identify which executives from the fund manager and counterparty must participate in the process; and dictate the qualifications of the mediator. Also, because planning for a potential mediation when negotiating a transaction takes on a collaborative character, if mediation ultimately becomes necessary, in implementing the agreed-to procedure, the parties will necessarily be moving through a process that they negotiated together and one that they adopted owing to a mutuality of economic interest and pragmatism. The parties will

therefore already be oriented toward achieving a resolution in which the benefits of the deal are reclaimed or an exit from the deal is negotiated and determined by the parties before hardened positions or litigation expenses make a fiscally prudent settlement difficult to achieve.

In addition, mandatory mediation provides a cooling-off period; allows for emotions generated by the dispute to abate; and forces parties to grapple with the question of whether bringing a dispute to arbitration or litigation is truly worth it. That is due in large part to the fact that the mediation process requires the parties to undertake a deliberate, comprehensive factual and legal evaluation of the merits of their positions earlier in the course of a dispute than if they reflexively commenced a litigation or arbitration, and to be able to justify their positions to the mediator. That evaluation often allows a party to identify weaknesses in its position or other legal, financial or practical challenges to proving its position that make a commercial settlement beneficial regardless of the merits.

Similarly, the format of a mediated settlement process allows aggrieved parties to have their cases heard and evaluated by a neutral third party in the context of a rule-based, structured process, which can be cathartic for parties who may be frustrated that their counterparties were not "hearing them" as the dispute materialized. Mediation gives a party its "day in court" with the attendant ability to articulate the business and legal base of its position and to fashion a resolution knowing that its counterparties must take that position into account when negotiating.

Of course, not every case will settle in mediation no matter how committed parties may be to the process; the issues between them may be too significant to resolve consensually. Nonetheless, the parties can use the mandatory mediation process to structure the ensuing contested proceeding – in arbitration or litigation, which are the next tiers in the dispute resolution provision – in order to streamline that proceeding and mitigate its impact. In doing so, they reap a considerable portion of the commercial benefits sought by including the multi-tiered dispute resolution provision in their transaction documents in the first place.

For example, parties can use the mediation process to define the scope of their dispute, including the claims and counterclaims that will be addressed in the arbitration or litigation. They can agree through the mediation to limit and focus discovery and depositions in the impending contested proceeding, which are often the most expensive and time-consuming elements of a case. The parties also can seek to agree to a case management schedule – to be approved by the arbitrator or judge – in order to achieve an efficient and timely resolution of the issues in dispute. Additionally, the parties can agree that they will return to mediation once the arbitration or litigation has reached a particular stage and prior to a final determination in order to make another attempt at fashioning a resolution that they control and that aligns with their best commercial interests.

Thus, while a mandatory mediation requirement may not result in the quick settlement of a dispute, it can effectively take disputed or disputable issues off the table and reorient the parties to a spirit of collaboration and pragmatism that can contain the scope of that dispute, allowing for a resolution in a

more efficient and less costly manner than might otherwise be the case.

How to Structure Effective Multi-Tiered Dispute Resolution Provisions

Establishing the Parameters of Mediation

A multi-tiered dispute resolution provision must be drafted to provide clarity and reliability as to how the process will play out. Most importantly, the parties should make clear that mediation is a condition precedent to the commencement of an arbitration or litigation, with an express exception for those proceedings seeking injunctive relief or provisional remedies that are required to maintain the status quo or protect a party's interests during the mediation.

Agreeing that mediation is a condition precedent to arbitration or litigation will allow a court to enforce the mandatory mediation provision as a matter of contract, and to dismiss or stay an arbitration or litigation that is improperly commenced prior to completion of mediation. The provision should also precisely detail how the mediation is to be commenced (*e.g.*, by sending a notice); the timeframe within which each phase of the mediation must take place; the logistics by which the mediation process can be terminated; and the rules pursuant to which the mediation will be conducted.

Imposing a specific timeframe within which each stage of the mediation must occur will limit the length of the mediation process and prevent delay through endless rounds of negotiations. For example, the parties should include deadlines for when a mediator must be selected, as well as how a mediator will be chosen by default if the parties cannot agree on a mediator; the time within which the mediation must commence after the mediator has been selected; and the minimum and maximum number of days for the mediation to take place, with the maximum able to be extended by agreement of the parties.

A clear provision for determining when the mediation process has terminated is also essential. That is especially true if, as noted above, mediation is a condition precedent to the commencement of an arbitration or litigation. One way of addressing termination is to provide that the mediator or a party – after the minimum mediation period has passed – shall have the authority or right to declare the parties at an impasse and to provide a notice of termination of mediation that will free the parties to move to the next tier of the dispute-resolution process.

Regarding the rules for the conduct of the mediation, while the parties can craft their own procedures, they would be best served by first considering the meditation procedures of the American Arbitration Association, JAMS or another well-regarded dispute resolution service. The comprehensive and time-tested rules of those services imbue the mediation with the procedural reliability that will allow the parties to realize the benefits of mediation discussed above. Conducting the mediation in accordance with the rules of a recognized dispute resolution service also provides considerable benefits in the selection of a mediator. The well-known dispute resolution companies have rosters of "neutrals" from which to choose, with biographical profiles that allow for the assessment of industry

expertise as well as of their mediation training and experience. That will facilitate selection of a neutral mediator best tailored to understand and resolve the parties' dispute.

The dispute resolution provision should also address other issues to advance the likelihood of a resolution, such as detailing who must attend the mediation, whether there will be limited discovery in aid of the mediation and whether the statute of limitations for claims will be tolled during mediation.

Ultimately, the parties have the ability to craft a multi-tiered dispute resolution provision to achieve their fundamental objectives which are, to summarize, the formulation of a process that allows for the parties to maintain control of how their dispute is resolved and thereby avoid, if possible, the imposition of a resolution that does not align with their commercial interests and objectives.

When Mediation Is Not the Answer

It should be noted, however, that a multi-tiered dispute resolution process may not be the best choice for every transaction. That is principally because it is expressly designed and intended to defer the commencement of an arbitration or litigation. There often are instances where the parties' relationship is so damaged or injury from contractual or fiduciary breaches is so severe that negotiation would be a waste of time, or the harm to a party would be exacerbated with the passage of time. The latter scenario can be guarded against by having, as discussed above, a carve-out from the dispute-resolution clause that allows for the commencement of a proceeding for injunctive relief, specific performance or other equitable remedies to maintain the status quo or prevent additional injury pending mediation or other negotiation.

There are occasions, however, where mediation – at least prior to contested proceedings – would not make practical sense under the circumstances and where there is no benefit in deferring initiation of a contested proceeding. That can be the case where the parties' relationship appears beyond repair, or for example, where insurance will cover the damages at issue, as insurance companies are notorious for refusing to fully negotiate settlements until the later stages of arbitration or litigation.

For these reasons, it is important up front to assess critically the nature of the relationship with transaction counterparties and whether it is one where mediation, in the case of disagreements, will be productive; reputation, prior deal experience and the tenor of the deal negotiations themselves are good indicators of that. Likewise, the nature of the transaction and anticipated remedies required in the event of a dispute, as well as the ability to seek those remedies quickly, must also be considered when deciding whether a multi-tiered dispute resolution provision is an appropriate course.

Ultimately, however, for disputes that will be economic at their core, investment managers seeking to maintain control over the cost, structure and results of the dispute resolution process should very seriously consider a multi-tiered dispute resolution provision. Mandating early case assessment and structured negotiation through a compulsory mediation process provides commercial parties with a real opportunity to move past disputes and to ensure that their institutional and fiscal objectives are not blown off course by an arbitration or litigation in which the timing,

costs, process and result can be very much out of their control.

See "Can an Arbitration Provision Signed by a Hedge Fund Manager, but Not by a Hedge Fund Director, Bind a Hedge Fund?" (Nov. 3, 2011).

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