MEDIATING FRANCHISE DISPUTES

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October 14-16, 2009
Westin Harbour Castle
Toronto, Ontario
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INTRODUCTION

As with most tasks, the successful and efficient resolution of a franchise dispute is most likely to occur when you use the right tool (or, in this case, the right process) to work on it. Sometimes, a dispute is best resolved through direct negotiation between the parties. Other times, adjudication with a binding decision by a judge, jury or arbitrator is necessary. However, more often than might be expected, the process most likely to advance the interests and values of both parties is mediation.

I. THE NATURE, ADVANTAGES AND DISADVANTAGES OF THE MEDIATION PROCESS

A. What Is Mediation?

Mediation is negotiation assisted by a neutral third party, whose role is to help those involved in a particular dispute clarify their business interests, overcome obstacles to communication, and fashion an efficient and realistic resolution of the matter. Mediation can be agreed to by the parties to a dispute at any time on their own initiative; it can be required in a franchise agreement in the hope of short-circuiting potential litigation; or it can be imposed by court rules or a specific court order.

The mediation process is flexible: The procedure followed can be ad hoc, governed by the rules of a commercial mediation service, provided for in a franchise agreement, or set out in a court rule or statute. But in the end, unlike the outcome in litigation or arbitration, any resolution achieved through mediation is totally voluntary and, by definition, acceptable to both parties.

B. Some Potential Advantages Of Mediation In Resolving Franchise Disputes

1. Relatively Low Cost

The cost of dispute resolution is a significant concern for both franchisors and franchisees. That has been true in the past, and it is particularly true in the current economic environment, especially in view of the ever-increasing costs and burdens of litigation and arbitration (for example, the additional costs imposed by the evolving rules relating to electronic discovery).

The cost of mediation, on the other hand, is relatively low. Mediation entails a limited expenditure of time by counsel to bring the mediator up to speed on the issues, facts, and legal arguments involved, and attendance by counsel and an executive with settlement authority at a mediation session that ordinarily will last no more than a day or two. Compared with the cost and burden of a year or more of full-blown discovery and evidentiary hearings that are expected in litigation and not uncommon in arbitration, a resolution through mediation can be very cost-effective.

The cost of mediation is also low in another sense: it does not foreclose other options. If mediation fails, the full range of adjudicative procedures remains as available as it was before.
2. **Informed Risk Management**

Mediators not only can help the parties focus their interests, facilitate communication with the other side, and foster an understanding of an adversary’s perspective, they can also give each party, separately and in confidence, a disinterested evaluation of the strengths and weaknesses of the case that that party will be presenting to a court or arbitrator if the mediation fails to produce a settlement. The mediator’s evaluation can be particularly effective because litigators are sometimes unable to bring themselves to deliver to their clients a totally unvarnished evaluation of the problems with their case. Moreover, counsel are sometimes prone to the same bias and partisanship that can affect their clients’ view of the case. And, in some cases, there may even be a suspicion that the other side’s lawyers are not fully advising their client of problems with the client’s case because the lawyers do not want the case to settle.

On the other hand, a mediator can offer a party a confidential preview of the objective evaluation that the case will receive in court. The mediator can help a principal appreciate that a favorable outcome in court is by no means assured, and that the cost in dollars and disruption of getting to a final ruling will be substantial. This confrontation with impartiality and reality may suggest to both lawyer and client that a modification of the party’s settlement position is a prudent acknowledgment of unfavorable facts or law, rather than a capitulation to the bluster of the other side’s lawyer. Indeed, it has been suggested that, because the mediator is an objective outsider, “an idea presented by a mediator as his own will be given consideration, while an identical offer coming from [the other side’s lawyer] will be viewed with suspicion.”

3. **Potential For Creative Crafting Of Settlements**

If a matter is resolved in court or by arbitration, the only issue is the merits of the claim presented. A mediator, however, can explore factors outside the complaint and look to the broader contours of the parties’ relationship in search of ways to get beyond the current impasse. This freedom to assess the overall relationship is particularly valuable in franchising, where continuing rights, obligations and opportunities provide a variety of potential tools extraneous to the claim itself to assuage particular franchisee or franchisor grievances. Franchisees may be interested in additional development rights or local advertising assistance; franchisors may be interested in having existing franchised units refurbished or new equipment installed. If, for example, the issue at hand is alleged encroachment, those other interests are legally beside the point because, if a judge or arbitrator decides the dispute, neither side would be entitled to anything more than the spacing policy set out in the franchise agreement. But the ongoing franchise relationship may give a mediator tools to fashion an overall business agreement that makes sense for both sides. While those types of potential trade-offs are more plentiful when attempting to resolve disputes concerning conduct during the term of a franchise agreement, accommodation of a broader range of interests can also be useful in resolving termination and post-termination disputes.

4. **More Favorable Environment To Preserve Relationships**

Particularly with a long-term relationship like a franchise, a mediator’s ability to separate the current emotions of the people involved from the business problem to be solved can pay large dividends. If a mediator can move the dynamics of the negotiation more toward the

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1 Dwight Golann, *Mediating Legal Disputes* 240 (A.B.A. 2009) (Golann refers to this phenomenon as “reactive devaluation.”)
that characterizes a business negotiation and away from the win/lose model of litigation or arbitration, a successful mediation can actually enhance the parties’ future relationship. That both parties, in the end, agree to the resolution, rather than one party's having a court's decision forced upon it, can have the same salutary effect. If, for example, a franchisee’s refusal to install a new computer system can be resolved in mediation by the provision of additional one-on-one training for the franchisee and its employees and facilitation of the installation of the equipment in the franchised units, the bond between the franchisor and franchisee may be strengthened, and the ultimate question whether the franchisor had the power to require the conversion to a new computer system in the first place can be set aside.

5. **Advantages To Both Parties**

All the advantages of mediation discussed above benefit franchisees and franchisors alike. Moreover, since any settlement through mediation will be purely voluntary, the process cannot result in a resolution that either party finds unacceptable.

6. **High Success Rate**

In mediation, agreement of the parties, rather than any particular substantive outcome, defines success. Based on that criterion, the success rate in mediations of franchise disputes appears to be relatively high. For example, the Franchise Mediation Program administered by the International Institute for Conflict Prevention and Resolution (“CPR”) claims an 80% success rate in cases where franchisees agreed to participate.

C. **Advantages Of Mediation Even If Settlement Is Not Reached**

Even if a mediation fails to result in a settlement of the parties’ dispute, the parties can benefit from participation in the process.

1. **Trial Preparation Refinement**

A mediator’s confidential evaluation of the strengths and weaknesses of a party’s case can alert trial counsel to those aspects that need bolstering and those likely to be effective. Similarly, the parties’ exchange of positions and arguments channeled through the mediator may give some insight into the approach the other side is likely to take at trial and the potential strengths and weaknesses of its arguments. Moreover, while factual statements made during the mediation are confidential and are likely to be inadmissible in a future evidentiary hearing, there is nothing that prevents a party from pursuing factual inquiries or legal arguments suggested by the parties’ interaction during the mediation process after the mediation has ended. Finally, even an unsuccessful mediation may narrow the issues in dispute between the parties, and thereby promote more efficient future discovery and a more focused trial.

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4 See Freund, supra note 2, at 12.
5 Managing Franchise Relationships, supra note 3, at app. I.
2. **Laying The Groundwork For Future Settlement**

Just as an unsuccessful mediation may narrow the issues for presentation at trial, it can also narrow the issues for resolution through later negotiation. In addition, the mediation process can give insight into which issues are more or less important to the other side, so that increased attention can be paid to how those issues might be resolved.

3. **Informed Risk Management**

Just as a successful mediation can result from a change in a party’s position as the result of a more informed assessment of the strengths and weaknesses of its case, the same process may confirm the strength and appropriateness of a party’s position. Thus, even if a settlement is not reached, the mediation process can generate for both parties a more developed, sophisticated and tempered assessment of the risks posed by pursuing litigation or arbitration.

4. **Advantages To Both Parties**

Again, all these potential benefits of even a failed mediation are available to both franchisors and franchisees. As one court stated:

> “Settlement of the whole case is not the only goal of mediation; ‘agreement’ is another goal, whether it be a factual stipulation, an agreement to forego jury trial in favor of binding arbitration, an identification of issues, a reduction of misunderstandings, a clarification of priorities, or a location of points of agreement. Thus, even where the odds of resolution are slim, mediation can be beneficial because other goals might be achieved.” *State v. Carter*, 658 N.E.2d 618, 623 (Ind. App. 1995).

D. **Some Potential Disadvantages Of Mediation In Resolving Franchise Disputes**

1. **Cost And Delay**

   While the cost and delay of a failed mediation are relatively small compared to the overall cost and time consumed by either litigation or arbitration, mediation does entail preparation, education of the mediator, and attendance at the mediation session, all of which translates into attorneys fees and a detour in the march toward a hearing on the merits of a dispute. In some disputes, where short time periods can make a difference, engaging in mediation may be seen as simply providing the other side an opportunity to stall. However,

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7 The court of appeals in *Stoehr* went on to note:

> Because the chance of effectuating many of these ancillary goals is greater when mediation takes place earlier in the litigation process rather than later, we suggest that parties attempt to mediate earlier to fully realize the benefits of mediation. However, we urge parties to conduct at least limited discovery prior to mediation so that they have an enhanced understanding of the liability and damages involved in the case, and therefore, they are better able to make informed decisions as to which issues, if any, can be conceded. *Id.*
mediation is an extremely flexible process and, while postponement of most aspects of litigation during the mediation process is generally desirable, an exception can be made for preliminary injunction proceedings and other circumstances requiring immediate action.

2. Neutralization Of The Advantages Of The Other Side’s Resources

Precisely because mediation offers the same advantages to both sides at relatively low cost, it can be seen as leveling the playing field to the disadvantage of the party with greater resources to devote to the battle. But the implications of one party’s greater resources (e.g., the franchisor’s deep pocket) or another’s ability to cause disruption (e.g., a franchisee’s right to pursue broad discovery) if the mediation should fail are in all likelihood already understood by the other party; and, if there is any doubt on that score, those implications can certainly be brought to the other party’s attention during the mediation. In other words, a party’s perceived advantages are likely to influence the course and the outcome of the mediation; they are not lost. If it is in both parties’ interest to resolve the dispute and get back to business, the temporary withholding of their respective firepower could make the use of that power unnecessary.

3. Loss Of The Opportunity To Make A Statement Through Aggressive Litigation Or By Winning In Court

There may be times when a franchisor or a franchisee views a dispute not as a necessary evil but as an opportunity to establish its willingness to defend its rights or to obtain legal precedent for the future. Even when you consider that a victory against one franchisee may not technically bind other franchisees in the future, the practical effect of a scorched-earth litigation policy or a win in court in one case can be a powerful deterrent to future litigation of the same claim by others. The same effect can arise from inflicting a substantial degree of disruption and expense before engaging in settlement talks. If those ends are what a party is seeking, mediation and any other settlement efforts are simply a waste of time and money. However, it is worth considering whether a particular dispute really falls into that category and how certain you are that the precedent ultimately established will be the one your client wants. Nonetheless, it is true that there are disputes that cannot be settled (or, from one party’s perspective, should not be settled) until a particular legal issue is decided. In those cases, the role for mediation may come after an initial ruling on that issue.

E. When Is Mediation Most Likely To Be Effective In Producing Settlement?

As discussed above, mediation is not likely to produce a settlement if a party’s real goal in the dispute is to show toughness or to obtain a judicial ruling on a particular point of law. On the other hand, if both parties deem it in their interests to resolve the dispute and move on, mediation can provide the framework to get beyond personal animosities and bruised feelings.

1. In-Term Disputes

In-term franchise disputes -- where the parties are going to continue to have a long-term, multi-faceted relationship going forward -- provide fertile ground for resolution through mediation. In that setting, the parties’ mutual interest in future good relations, the variety of their inter-relationships, and the cost to both sides of resolving an existing dispute through litigation can provide a mediator with useful tools in attempting to find areas of agreement. The odds of success go up further when the dispute involves facts limited to a single franchisee. If the central issue in a dispute is peculiar to one franchisee at one point in time, a franchisor can feel
freer to compromise on the issue than if the dispute involves an issue of system-wide significance (e.g., payment of royalties for particular services, use of approved suppliers). Even with system-wide issues, mediators may be able to draw on other aspects of the continuing relationship to find ways to balance franchisee or franchisor concerns.

2. Disputes That Turn On Issues of Judgment Rather Than Hard Contractual Rules

If a franchise agreement requires the payment of a 5% royalty, a settlement predicated on a reduced royalty rate for one franchisee is likely to be a tough sell (though even then some type of deferral arrangement might form a basis for settlement). However, in cases where many facts tend to inform a final judgment -- with a claim such as encroachment, for example -- a mediator may be able to help clarify the issues, bring consensus to impact measurement, defuse suspicion, and forge an agreement.

3. Cases Where, For Whatever Reason, One Side Does Not Really Understand The Other Side's Position Or The Basis For That Position

The low-intensity explanations of a mediator can, at times, bring an appreciation of an adversary’s case that simply reading the other side's briefs cannot. Moreover, even with a case in which the law and the facts are clearly on one side or the other, mediation can be far from a waste of time. Rather, it may be possible for a party to be brought to an understanding that it is better to accept the weakness of its case than to spend time, effort, and resources fighting a losing battle. That is particularly true when the franchise agreement requires the loser in litigation to pay the winner’s attorney’s fees.

F. Confidentiality Of The Proceedings

The confidentiality of communications that take place in a mediation is as critical to the chances of the mediation’s success as confidentiality is to any other form of settlement negotiation. As part of the dynamic of the process, parties must be able to vent their frustrations, make their arguments, and explore possible settlement scenarios without fear that their words will come back to haunt them in court. This is equally true for communications directly between the mediating parties and for communications between each party and the mediator separately.

Accordingly, there are a wide variety of statutes, court rules, and rules adopted by professional mediation services that are designed to lay a mantle of confidentiality over mediation proceedings. For example, Rule M-10 of the American Arbitration Association Commercial Mediation Procedures provides:

M-10 Confidentiality

Subject to applicable law or the parties' agreement, confidential information disclosed to a mediator by the parties or by other participants (witnesses) in the course of the mediation shall not be divulged by the mediator. The mediator shall maintain the confidentiality of all information obtained in the mediation, and all records, reports, or other documents received by a mediator while serving in that capacity shall be confidential.
The mediator shall not be compelled to divulge such records or to testify in regard to the mediation in any adversary proceeding or judicial forum.

The parties shall maintain the confidentiality of the mediation and shall not rely on, or introduce as evidence in any arbitral, judicial, or other proceeding the following, unless agreed to by the parties or required by applicable law:

i. Views expressed or suggestions made by a party or other participant with respect to a possible settlement of the dispute;

ii. Admissions made by a party or other participant in the course of the mediation proceedings;

iii. Proposals made or views expressed by the mediator; or

iv. The fact that a party had or had not indicated willingness to accept a proposal for settlement made by the mediator.

An agreement to proceed under the AAA Mediation Procedures constitutes incorporation of this provision into the parties' mediation agreement.8

However, there are significant differences in the scope of the protections provided by the many regimes adopted by statutes, courts, and mediation services to protect mediation confidentiality. With respect to mediation of cases pending in federal court, the Alternative Dispute Resolution Act of 1998, 28 U.S.C. §651 et seq., required each federal district court to develop and implement “alternative dispute resolution processes.” As part of its program, each court was required to “provide for the confidentiality of the alternative dispute resolution processes and to prohibit disclosure of confidential dispute resolution communications.” Id. at §652(d). However, the scope and application of the confidentiality provisions adopted by different federal courts pursuant to this directive can differ significantly.9 Adding to the disparity in approach, some federal courts have recognized a federal common law mediation privilege.10 Similarly, every state has a statute granting some sort of protection to mediation communications.11 But again, the protection afforded by those statutes can vary unexpectedly and significantly.12

In sum, it is incumbent on counsel for the parties to assure themselves that the protections for mediation communications provided by applicable statutes and rules are


12 On the stricter side, some state statutes have even been interpreted to prevent introduction into evidence of mediation communications to prove that a settlement was reached during the mediation. See, e.g., National Union Fire Ins. Co. v. Price, 78 P. 3d 1138 (Colo. App. 2003).
adequate. If a desired aspect of protection appears lacking, counsel should consider seeking to add further protections through supplementary agreement with the opposing party.  

II. DRAFTING THE MEDIATION PROVISION

The nature of the franchisor/franchisee relationship is that the franchisor drafts the franchise agreement, and a prospective franchisee may have some power, though limited, to negotiate changes to the franchisor’s standard contract. Thus, for practical purposes, it is the franchisor who decides whether to include mandatory mediation as part of its dispute resolution process. Accordingly, for the most part, this section discusses drafting from the franchisor’s point of view.

The primary purpose for including a mediation provision in the franchise agreement is to prevent either party from bringing suit until the parties have first sought to settle their dispute through mediation. In section A below, we address considerations regarding whether to include a mandatory mediation provision in the franchise agreement. In section B, we discuss clauses that a franchisor should consider if it does include a mandatory provision in its agreement.

A. Pros And Cons Of Mandatory Mediation

Many considerations come into play in deciding whether to require mediation. The discussion below is necessarily in the nature of opinion, but we strive to isolate the various factors involved in assessing the merits of mandatory mediation.

1. Relationships

The franchisor/franchisees continues during disputes and often after disputes are resolved. Even an ex-franchisee has the power to speak credibly about the brand, and prospective franchisees may call the terminated franchisee to learn about the brand. Because franchisor and franchisee are locked in a continuing relationship of some sort, both parties gain from resolving disputes quickly and voluntarily on mutually agreeable terms. Mandatory mediation provides the opportunity to do so.

2. The Overlay Of Item 3

Under Item 3 of its franchise disclosure document, which must be given to prospective franchisees under the Federal Trade Commission’s Rule entitled “Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures,” a franchisor must disclose a civil action between the franchisor and a franchisee. If the action is material, the franchisor must disclose any findings of liability against the franchisor. Also, if the case is settled, the franchisor must disclose the settlement terms. Because of these disclosure

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13 For a good discussion of these issues, see Gardner, Sturm & Yoon, supra note 9, at 10-14.


16 16 C.F.R. § 436.5(c) (2009). Under this section, the franchisor must “[d]isclose whether the franchisor…”:

(i) Has pending against that person:
obligations, franchisors are reluctant to settle disputes on terms that will give the appearance that the franchisor seriously erred or that the franchisor folds easily once sued. One consequence of the requirement that settlement terms be disclosed may be that franchisors choose to take more suits to trial or hearing rather than settle on what will be public terms.

Franchisors have more leeway to resolve a dispute before suit is filed because Item 3 does not require franchisors to disclose the terms of a resolution at that stage. The franchisor can further protect itself by obligating the franchisee to keep confidential any pre-litigation settlement. Given Item 3’s disclosure obligation, franchisors and franchisees each benefit from mandatory mediation inasmuch as the franchisor has more flexibility to resolve the dispute before suit is filed.

3. The Lousy-Lawyer Problem

“If men were angels, no government would be necessary.” Likewise if all lawyers representing franchisors and franchisees were knowledgeable and reasonable, mandatory mediation would not be necessary. Good lawyers understand the power of mediation, recognize the value of resolving disputes early, know how and when to use mediation as a tool, and know how to structure mediation either to resolve or manage the dispute. Thus, absent special goals that can be attained only through suit, good lawyers as a matter of course consider negotiation and mediation before filing an action.

(A) A... material civil action alleging a violation of a franchise, antitrust, or securities law, or alleging fraud, unfair or deceptive practices, or comparable allegations.

(B) Civil actions, other than ordinary routine litigation incidental to the business, which are material in the context of the number of franchisees and the size, nature, or financial condition of the franchise system or its business operations.

(ii) Was a party to any material civil action involving the franchise relationship in the last fiscal year....

(iii) Has in the 10-year period immediately before the disclosure document's issuance date:

* * *

(B) Been held liable in a civil action involving an alleged violation of a franchise, antitrust, or securities law, or involving allegations of fraud, unfair or deceptive practices, or comparable allegations....

* * *

(3) For each action identified in paragraphs (c)(1) and (2) of this section, state the title, case number or citation, the initial filing date, the names of the parties, the forum, and the relationship of the opposing party to the franchisor (for example, competitor, supplier, lessor, franchisee, former franchisee, or class of franchisees).... In addition, state:

(i) For pending actions, the status of the action.

(ii) For prior actions, the date when the judgment was entered and any damages or settlement terms. [Internal footnote: If a settlement agreement must be disclosed in this Item, all material settlement terms must be disclosed, whether or not the agreement is confidential...]

(iii) For injunctive or restrictive orders, the nature, terms, and conditions of the order or decree....

The franchise bar has many good lawyers. Through the ABA Forum on Franchising, the International Franchise Association, and other organizations, many of these lawyers have also developed a cordiality that helps franchisors and franchisees settle disputes early and on reasonable terms. Unfortunately, though, many lawyers who end up representing franchisees or franchisors may not understand franchise law well, or they may not understand mediation well, or they may be lawyers who would prefer the bounty of litigation fees to the meager returns from an early and fair settlement.

The lousy-lawyer problem cuts both ways as to whether to mandate mediation. On the one hand, a mandatory mediation provision provides the opportunity to have the parties hear the independent voice of the mediator, who may be able to offer insight to a party that has a lousy lawyer. This offers the possibility of early settlement rather than a costly, bitter litigation. On the other hand, where one party has a lousy lawyer, mediation may be futile because the lousy lawyer stands a good chance of destroying the trust necessary for a mediation to succeed.

4. Risk Management

Mandatory mediation is a good risk management tool because it forces the franchisor to assess the franchisee’s case early, before costly discovery. The mediator should be able to help provide an objective assessment. This also benefits the franchisee. It increases the opportunity to make an early decision on resolution that is intelligent and reasoned.

5. Cost

Nearly all franchise disputes are resolved before a trial or final hearing.\textsuperscript{18} Thus, resolving them early benefits both sides because it saves them the attorneys fees and diverted management time involved in litigating the dispute until a settlement late in the process. Mandatory mediation forces the parties to consider early resolution. Another benefit as to the overall cost of the litigation process is that even if the parties do not resolve the dispute, they can reach agreement on how to manage the costs and time of the dispute.

A contrary consideration is that mediation can be costly. Mediation can be a waste of time and money if the parties do not resolve the dispute, agree on how to manage the time and cost of the dispute, or materially advance their understanding of the other party’s case.

Another contrary consideration is that franchisors may feel that they will not compromise on certain types of disputes, such as quality control for example. Or the franchisee may simply have stopped paying royalties because of business concerns with the franchisor, but without any legal claim against the franchisor. In these cases, the franchisor may simply want to file litigation, insist that the franchisee comply with the franchisor’s demands, and pursue the matter through trial or hearing.

\textsuperscript{18} See Edward Wood Dunham and David Geronemus, \textit{Franchise “Litigation”: Understanding the Interplay of Litigation/Arbitration Outcomes And Settlement Negotiation in the Resolution of Franchise Disputes}, 2002 ABA Annual Forum on Franchising (October 9-11, 2002) at 12 (based on survey of 2001 UFOC’s of 30 of the top 100 systems in total units, 71% of cases settled).
The cost of mediation poses special concerns for franchisees. Most mandatory mediation provisions provide for mediation in the franchisor’s home city. A franchisee may feel that mediation will simply be an added burden on its limited resources to fight the franchisor, and that the franchisor will not make any concessions until the franchisee can obtain discovery to prove a material violation of either the franchise agreement or an applicable franchise relationship or business opportunity statute. This is a legitimate concern, but good franchisee counsel should be able to structure the mediation to keep costs down, and to manage the dispute in such a way that the franchisee can obtain the discovery it needs to assess the case without incurring extraordinary costs from all-out litigation.

As an example of using mediation to manage cost, franchisor and franchisee counsel and the mediator may decide that the parties should do limited discovery on a critical issue before they start the mediation. Or the parties may resolve certain issues at mediation and then set a framework for resolving others based on doing limited discovery such as deposing a key witness on limited issues. If the deposition would require travel, the parties may agree to conduct the deposition by telephone. Then the parties could agree to reconvene the mediation, which might also be done by telephone. Mediation is flexible enough to allow counsel to craft an efficient and economical path to resolve the dispute.

6. Ripeness

A concern related to cost is ripeness. Some disputes present each side with too many unanswered questions to allow for early resolution before discovery, which may make mandatory mediation a waste of time and money. With good attorneys on each side, however, the parties could each develop a better understanding of the other’s case, and could agree to procedures that will minimize the time and cost required for adjudication of the dispute.

7. Avoiding The Appearance Of Weakness

Absent a mandatory mediation provision, either party may be concerned that it may signal weakness if it is the first to suggest mediation to the other side. With good lawyers on each side of the dispute, this is less an issue because mediation is now a commonly-accepted tool that good lawyers consider at the inception of any dispute. If there is a lousy lawyer on one side, though, the mandatory clause forces mediation without creating any misimpression of weakness.

The CPR has addressed this concern with the CPR Pledge. Businesses that adopt the pledge agree that if they are in a dispute with another business that has subscribed or will subscribe to a similar statement, the business is “prepared to explore with that other party resolution of the dispute through negotiation or ADR techniques before pursuing full-scale litigation.”19 Over 4000 businesses have signed the pledge, including many franchisors.20 There are separate pledges for corporations and law firms. The CPR’s discussion of the pledge directly address the pledge’s usefulness in avoiding the appearance of weakness in proposing


mediation (or, more generally, alternative dispute resolution).\textsuperscript{21} A substantial number of franchisors have also signed a Commitment to the CPR Procedure for Resolution of Franchise Disputes,\textsuperscript{22} which commits the franchisor, if the franchisee requests, to use the CPR's mediation program\textsuperscript{23} to resolve disputes.

8. \textbf{Requiring Good Faith}

One downside to mandatory mediation provisions is that even if a clause states that the parties shall participate in good faith, the contract can not, as a practical matter, force either party to do so.\textsuperscript{24} If either party participates in bad faith, the mediation is a waste of time and money. And franchisees often view mandatory mediation as a device to drain their resources. A good mediator, however, can sniff out bad faith and can take steps to encourage the parties to consider resolution in good faith, but no mediator has a magic wand to change a party that refuses to be open to resolving the dispute on fair terms.

9. \textbf{Special Litigation Goals}

Franchisors have certain special dispute-related interests that require immediate protection. Common examples are a franchisee’s misusing the franchisor’s trademark, violating confidentiality restrictions, engaging in illegal activity, or endangering public health. The franchisor needs to seek injunctive redress immediately, and can not pursue mediation before filing suit. This does not, however, mean that the franchisor should not use a mandatory mediation provision in its agreement. Rather, if the franchisor uses a mandatory clause, the franchisor should provide an exception for specified injunctive actions where immediate relief is needed.

Franchisors may also believe that certain disputes require that the franchisor sue and prevail against the franchisee so as to send a message to other franchisees or for reasons of principle. In these cases, the franchisor may not want to be delayed by mandatory mediation. On the other hand, a mandatory provision can specify an expedited timetable for the mediation. The franchisor could use the mediation to convey its position. It may be able to resolve the suit without compromise, or it may learn information that would lead it to resolve the dispute with well-warranted compromise.


\textsuperscript{22} Id.

\textsuperscript{23} The obligation to mediate in good faith is discussed \textit{infra Part VI(B)(2)}. 

\textsuperscript{24} Id.
10. **Availability Of Court-Ordered Mediation**

Many courts now have mandatory mediation programs. Even where no pre-existing program exists, many judges are active in encouraging parties to mediate or ordering them to do so. This increases the likelihood that parties will end up in mediation even in the absence of a mandatory mediation provision in their franchise agreement.

The mandatory provision, however, does offer advantages over court-ordered mediation. It directs the parties to mediation before the suit is filed and increases the prospects for early resolution. Also, many court programs are designed to handle a large volume of cases, and complex franchise cases may not receive the attention they require to reasonably probe settlement.

11. **Time To Cool Off**

An advantage of early mediation is that it gives parties time to cool off. Disputes usually simmer for awhile, and attempts are made to resolve them through direct negotiation. At times, the negotiation can end in a way that leaves one or both parties angry. Mandatory mediation gives an angry party time to cool down and make rational decisions.

12. **Avoiding The First-To-File Pressure**

Another advantage to a mandatory mediation clause is that it puts on hold the first-to-file pressure. Depending on the venue selection clause in the franchise agreement and whether the franchisee is in a state that protects against venue selection clauses, parties may gain the home-court advantage when filing first.

Mandatory mediation prevents the first-to-file pressure. Where the clause exists in an agreement, and one party files first to establish venue, the opposing party has a reasonable argument that the complaint should be dismissed or a strong equitable argument that the suit should not be entitled to any favorable consideration normally accorded to the first to file. Courts have disagreed, however, about whether suing before mandatory mediation has occurred is a proper basis for dismissal.25

13. **A Postscript: The Franchisee’s Perspective**

As a general matter, a franchisor has far more resources than a franchisee to wage full-scale litigation. Thus franchisees have a large incentive to resolve a dispute early. Mandatory mediation forces the franchisor to discuss resolution before either side invests substantial

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resources. Also, even if the suit does not settle, the parties can reach agreement on how to manage the costs and time of litigation.

To a franchisor, a dispute with a franchisee is one of many matters the franchisor is dealing with, and it may be a low priority. With a large franchisor, the dispute could enter litigation after simmering at a middle-management level and never having received a serious review from senior management. Mandatory mediation may force senior management to take a hard look at the dispute early in the process.

A clause that requires the mediation to take place in the franchisor’s home city provides a disincentive to franchisees because it increases the franchisee’s costs. Another cost issue is that if a franchisee has a lousy lawyer, the lawyer may run up fees on the mediation, negotiate incompetently or even in bad faith, and then complain about how mandatory mediation is a tool for franchisors to drain franchisees’ resources. On the other hand, a good franchisee lawyer will address the location issue directly with the franchisor and the mediator, and suggest ways to lower costs to protect the franchisee. For example, the franchisee’s lawyer could request that the mediation be moved to the franchisee’s home city. Or the parties could engage in pre-mediation activity to determine whether face-to-face mediation would be productive, or even whether the lawyer might participate by phone.

Mandatory mediation can also help with another lousy-lawyer problem. Franchisees may hire lawyers who are not competent in franchise law. At times, these incompetent lawyers advise that the franchisee has a great case based on some special statutory provision or common law rule applicable to franchises, while a competent franchisee lawyer would know that the law or rule does not apply. Mandatory mediation gives the franchisee the chance to hear an objective evaluation of the case, and may prevent the franchisee from bankrupting itself pursuing a quixotic theory.

In short, so long as the franchisee has a lawyer who is knowledgeable in franchise law and ADR and who is acting in good faith, mandatory mediation offers the franchisee many benefits.

B. Terms To Include In A Mandatory Mediation Provision.

If the franchisor chooses to include a mandatory mediation provision, the next question is what terms to include in the provision. There are a number of issues to consider.

1. Define The Dispute

Some mediation provisions are limited to covering claims “arising out of or relating to this contract, or the breach thereof,” which is the standard American Arbitration Association language. That provision can lead to disputes about what falls within the defining language. A broader definition that eliminates these issues could state that all claims between the parties are subject to mediation (and any other specified ADR procedures).

2. Specify A Mediation Service

Organizations such as the AAA and JAMS administer mediations. Both have a roster of highly qualified mediators, and they assist the parties in selecting a mediator and in other administrative matters such as scheduling and, if appropriate, pre-mediation information.
exchange. They also, directly or indirectly, charge a fee for their services. CPR assists the parties in choosing a mediator and provides a structure for non-administered mediations.

If the provision does not specify a mediation service, the parties will need to agree on selection of a mediator. Mediation and skilled mediators are sufficiently widespread now that, so long as a lousy lawyer is not throwing sand in the gears, the parties should be able to choose an excellent mediator on their own,\footnote{Some organizations, like CPR, have a list of mediators whom parties can contact directly. \textit{Int’l Inst. for Conflict Prevention and Resol., CPR Specialized Panels} (2009), \url{http://www.cpradr.org/tabid/377/q/Franchise/cod/1/default.aspx}.} and the mediator will administer the procedure.

3. **Define Mediator Qualifications**

A provision may require that the mediator chosen have certain qualifications. One question is whether to require a mediator with expertise in franchising. There is no right answer. As a general matter, experienced mediators who are also knowledgeable in franchising will likely be a quicker study (if the issues are complex) and may have more insight into the business practices and culture in franchise disputes, which can help in fashioning a business resolution. On the other hand, mediators who are franchising experts may, unwittingly, substitute their judgment for the parties’ and lawyers’. This can be counterproductive, especially if the mediator’s experience is primarily from either the franchisor or franchisee side. The party on the other side from the mediator’s experience may perceive the mediator as biased. One solution would be to require that the mediator have experience representing both franchisors and franchisees, but that limits the pool of potential mediators significantly.

Further, any skilled mediator should be able to understand the issues involved in a franchise dispute, and how to work with the parties to generate possible business solutions to their dispute. Thus, another approach is that the provision could define general qualifications, such as that the mediator must be on the roster of a services provider that screens prospective mediators, such as the AAA, JAMS or CPR.

Or the parties could simply not define qualifications for the mediator. The practice of mediation is sufficiently developed that skilled mediators with good process expertise are reasonably easy to find. Most litigators will know of skilled mediators or will know how to solicit recommendations from other lawyers.

4. **Time Limits**

If mediation is a condition precedent to bringing suit, the provision should state that either party may trigger mediation by written notice, and that either party may bring a legal action if the dispute is not resolved within a set number of days.

5. **Costs**

The provision should specify who bears the costs of the mediator’s fees, and whether each party is responsible for its own costs and fees. If the franchisee needs to travel, an approach to consider is that the franchisor share half the franchisee’s cost.
6. **Place**

The provision should select the location of the mediation. Many franchisors choose the location of their principal place of business for their convenience. Thought should be given, though, to selecting the franchisee’s principal place of business. That choice can be a sign of good faith and can build the trust that mediation requires to succeed.

7. **Specify Participants**

For mediation to be effective, each party’s decision-makers need to be present. The clause may specify who needs to be present or that the person present must have full settlement authority.

8. **Tolling**

The provision should specify that the statute of limitations is tolled during the time of the mediation. Otherwise, before the end of the mediation period, either party may be placed in the bind of having to file an action to prevent the running of the statute.

9. **Good Faith**

Mandating good faith by contract may be illusory. As a practical matter, a court will probably decline to delve into whether a party bargained in good faith during a mediation. Also, confidentiality obligations in a mediation present another obstacle to examining the parties' conduct. Still, placing the requirement in the contract does establish expectations and may offer some protection if the other party’s bad faith is egregious.27

10. **Exception For Injunction**

The provision should provide that either party may seek temporary or preliminary injunctive relief in specified emergencies, such as when necessary to preserve trade secrets and confidentiality, protect trademarks, or prevent a danger to the public or the breaking of a law.

11. **Sample Clause**

The following is a sample clause that addresses all the issues above:

a. **Duty To Mediate**

If either party believes it has a claim against the other, that party must mediate the dispute as a condition precedent to filing a [complaint, arbitration demand] to enforce the claim.

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27 The approach of courts and bar ethics committees toward the obligation to mediate in good faith is discussed infra Part VI(B)(2).
b. **Starting Mediation**

Mediation is started by serving written notice on the other party pursuant to [notice provision in agreement]. The date of sending the notice is the “Notice Date,” and the date of receipt of the notice is the “Start Date.”

c. **Mediator**

The parties shall jointly select the mediator, and shall make a good faith effort to select a mediator with demonstrated knowledge in the area of franchise law. If the parties are unable to jointly agree on a mediator within ten days of the Start Date, the party serving notice must commence mediation administered by the American Arbitration Association under its Commercial Mediation Procedures.

d. **Place, Costs**

The mediation shall take place in [location]. Each party is responsible for its own costs and shall equally split the mediator’s fees and costs.

e. **Participants, Good Faith**

Each party’s chief executive officer, or another officer or employee with full decision-making authority, must participate in the mediation, and shall mediate in good faith.

f. **Time Limitation On The Filing Of An Action; Injunction Exception**

If the parties fail to resolve the dispute through mediation within 45 days of the Start Date, either party may then file a [complaint, arbitration demand] against the other. The only exception to this required waiting period is that either party may bring an action for preliminary or temporary injunctive relief against the other to enforce paragraphs [_____] of this agreement.

g. **Tolling Of The Statute Of Limitations**

Beginning with the Notice Date, and continuing through 45 days after the Start Date, the statute of limitations on all of each party's claims are tolled.

III. **THE MEDIATION/MECCHANICS AND STRATEGY**

A. **Who Initiates?**

If the franchise agreement has a mandatory mediation provision, the party initiating the mediation would follow the procedure set out in the agreement. If there is no such provision, the initiating party simply inquires whether the other side is interested in mediating the dispute. While there may be some concern that raising mediation may create an appearance of weakness, that concern has for the most part lost its sting as mediation has become commonplace in contracts and court rules.28

28 [See supra Part II(6)(A).]
B. Selecting The Mediator

Whether parties are required to mediate by contract, or they voluntarily agree to do so, the first decision facing them is choosing the mediator. A fairly standard method for choosing a mediator is for each side to develop a short list (3 - 5) of potential mediator names and exchange the lists. Obviously if one name appears on both lists, the job might be done. Otherwise, parties might use alternate strikes to arrive at their mediator. One downside to this approach is that it can result in the parties’ choice being based on the lowest common denominator.

Another method for choosing a mediator offers the potential for a more discerning choice. First, the parties might engage in a discussion of what they are looking for in a mediator to see if they can agree on the mediator qualities that might be most useful to the disputants. If they agree on those qualities, they can then develop a joint list of potential mediators. The parties should then interview the potential mediators on the joint list (probably by telephone, but preferably in person) to see if they can agree on a choice. If they are unable to agree, the parties can always resort to the strike-list method of choosing. At the end of this process, even if the parties cannot agree following the interviews, they are assured of a mediator who has the qualities they agreed would be most helpful.

Some litigators believe that if the parties plan to choose a mediator by exchanging lists, the smart thing to do is generally to examine the credentials and experience of the proposed mediators on the other side’s list, and if satisfied with the list (or some of the names on it), simply say, “You choose.” The theory behind this approach is that if the mediator has to bear down on the parties to help them reach an agreement, the chosen mediator is likely to be more persuasive with the other side because they chose the mediator.

Finally, if the parties cannot agree on a mediator, they can use mediation service providers like the AAA or JAMS to administer the mediation and to use their standard administered procedure for selecting the mediator.

C. Pre-Mediation Preparation

In an ideal world, each adversary would prepare for the mediation as one would for a summary trial. The goal is to gather detailed information so as to (i) determine the value of the dispute as objectively as possible, and (ii) present to the mediator the evidence and legal support to persuade your opponent that your valuation is on target. Thus, to prepare, you would research the legal and evidentiary issues, and would have a good idea of the strengths and weaknesses of each side’s case. If discovery has not been done, you would interview key witnesses and review key documents. If discovery has been done, you would excerpt the strong testimony from your witnesses and the damning testimony from your adversary’s. If experts have not yet been disclosed, but expert testimony will be key to the case, you should consider retaining an expert to offer insight on dispositive issues.

Another consideration is whether an exchange of information before the mediation is needed. For example, in a case claiming that the franchisee under-reported revenues or that the franchisor has redirected marketing fund money, the mediation might not be worthwhile until an audit occurs. Still, while trial lawyers are by nature uneasy operating without discovery, resisting the urge to demand information exchange may be worthwhile unless the information is truly needed. The goal of early mediation, after all, is to resolve the dispute before the parties incur significant expenses.
Finally, and while it may be obvious, you need to tailor the amount of your preparation to the case’s value. Nonetheless, putting in appropriate effort at the mediation stage can save the substantial expense in proceeding to litigation.

D. Developing The Negotiation/Settlement Target Strategy

Once the parties have prepared the issues, the next step is to develop settlement goals. Some goals may be creative. For example, in a hotel dispute, could the franchisee convert to one of the franchisor’s lower-price point systems? Or would the franchisor be willing to buy the property and run it as a corporate unit or refranchise it?

Another part of thinking through settlement goals requires a quantitative analysis -- how much is the case worth for purposes of settlement? Many disputes hinge primarily on money. But even as to disputes with significant non-monetary issues, once the parties have a grasp of the monetary value, they can intelligently assess the merits of the creative options for resolution. Thus assessing the monetary value of the case is a vital step to prepare for any mediation.

The standard procedure for assessing monetary value is to begin by estimating your client’s worst and best alternatives to a negotiated agreement, which is referred to as the WATNA and BATNA. In calculating each, you should include attorneys fees and other litigation costs and, if possible, quantify the cost of executive or principal time that will be spent on the litigation rather than business. You can further refine your calculations by calculating your adversary’s BATNA and WATNA. Using these numbers, you can try to set likely target goals for a reasonable settlement and you can then present reason-based numbers to help arm the mediator to persuade your adversary of the merits of your client’s settlement position.

The quantitative approach is one key step in evaluating settlement goals. It forces you to think clearly and rigorously about your client’s and your adversary’s positions. Before fixing settlement goals, however, you also need to consider your client’s non-monetary interests and values. Among those values and interests may be the message that settlement would send to your client’s adversary, customers, competitors or investors. What message best advances the client’s current business strategy? You should also think through how your adversary views the message that settlement may send.

Consider irrational factors as well. Disputes often arise because of mistakes, and mistakes inevitably raise all-too-human issues of blame, defensiveness, pride, and ego. Consider how those issues affect your own case, and how your adversary may be analyzing its case.

Another important factor to consider is your client’s and your adversary’s risk tolerance. Does the client want to be conservative and risk-averse or aggressive and risk-tolerant. This ties deeply to business culture, business strategy, operating issues, finances, timing, investor relations, personality, and many other issues. The quantitative approach should inform your client’s settlement analysis, but your client’s values and interests should dictate the settlement you seek.


Once all these issues have been resolved, you should have coherent and reasonable settlement goals, which should in turn frame how you approach the actual mediation. Having thought through and articulated them, you will be able to decide how to advance your client’s interests and values at the mediation most forcefully and persuasively.

E. The Initial Conference And Setting Ground Rules

Typically, the mediator will want to have an initial conference call with the parties to talk through, at a minimum, the logistics of the actual mediation session. If the mediator does not ask for an initial conference call, it makes sense for the parties to request one. In an initial conference call, the parties and mediator will want to:

- confirm the date, place, time, and minimum duration for the mediation;

- confirm who will be attending for the parties, and that the party representatives will have full settlement authority;

- discuss mediation statements for the mediator;

- discuss and resolve any pre-mediation issues such as information exchanges;

- discuss any other preparation necessary for the mediation.

Another issue that should be addressed is *ex parte* contacts. No proscription exists against *ex parte* contact in a mediation, and thus it may occur unless the parties and mediator agree otherwise. But it is the better practice for the mediator and parties to discuss whether the parties can call the mediator *ex parte* to discuss an issue, and whether the mediator may call either party *ex parte* to initiate a discussion.

F. Pre-Mediation Disclosures To The Mediator

Most mediators ask the parties to submit mediation statements to them prior to the mediation. If the parties do not understand much about the position of the other party to the dispute, the statements might best be shared. The limitation of sharing mediation statements is that parties tend to gloss over weaknesses in their positions and to be guarded about settlement possibilities. If the mediation statements are going to be shared, the parties might consider separately sending the mediator a short confidential statement that focuses on key issues that cannot be shared initially, any particular problems the party sees, and perhaps, potential settlements. If the statements are to be shared, the advocates will have two goals in mind: informing the other side about salient facts (and law) in their client’s favor and persuading the other side that it should reconsider its view of the dispute.

A critical question for advocates is whether, before the mediation, the advocate should share with the mediator information regarding any personality quirks, eccentricities or irrational thinking on the part of anyone planning to attend the mediation. If the information might be useful in helping the mediator fully understand the impediments to settlement, the best practice is to share the information with the mediator. The sensitivity of this type of information is such, however, that a telephone call may be the best way to inform the mediator.

Mediation is a persuasive process. If you and your client have carefully thought through the client’s values and interests, and its resulting goals for the mediation, you should be able to
create a powerful mediation statement that shapes the mediator’s and your adversary’s views of the case.

G. Opening Statements

A typical commercial mediation session follows a pattern in which the mediator starts with the parties together and then separates the parties for a series of individual meetings. For the opening session, the lawyer and client must make some initial strategic choices. Sitting across the table will be the most important person in the mediation from their vantage point – the adversary’s decision-maker. An opening statement should be designed to persuade that decision-maker that his view of the world about the issue in dispute should be altered to more closely resemble yours. It should not harangue or belittle the other side, as that is likely only to harden your adversary’s views. A carefully-thought-out opening statement can change the dynamic of the entire mediation.

Some mediators dispense with the opening statement and start immediately with caucusing. This approach may be better when either each side is fully apprised of the other’s case, or when the emotional tension between the parties is so acute that putting them together in a room at the start of the session would be only detrimental. If you have views on whether opening statements would help or hurt the process, let the mediator know.

H. Caucusing

Progress in a mediation is often fitful – with slow, uneven movement in the early stages of the session, followed by bursts of progress and returning to fits and starts near the end of the session. It is important, and sometimes difficult, to remain focused on the task at hand.

One of the beauties of mediation is its adaptability to the parties’ needs. So, for example, if the parties need to exchange information before the actual mediation session, they can engage the mediator to help them agree on what needs to be exchanged and how best to do so. Similarly, they might discuss with the mediator whether involving experts in the session would be useful. It is important for lawyers to remember that mediation’s power lies not in its ability to determine the truth – courts and arbitrators do a good job of that. Mediation’s power, instead, is to help parties resolve their differences and look towards the future. Given the difference between the adjudicatory processes and mediation, it makes little sense to spend a great deal of money in mediation on experts or information-sharing.

Taking advantage of the power of mediation does take preparation, just a different kind of preparation than one thinks about for trial (or arbitration). One of mediation’s substantial benefits is the opportunity to speak directly to the other side’s decision-maker. That opportunity should not be squandered, which means that the team on each side needs to prepare for the mediation. This preparation should include determining what the most important points are for the other side’s decision-maker to absorb, and which member of your team is most likely to be persuasive on which points. In other words, attorneys and principals should not assume that the mediation should proceed with the attorneys doing most of the talking – either to the other side or to the mediator. In fact, many good mediators will work very hard to get the principals talking (generally in separate sessions). They are the ones, after all, who will have to live with the failure to resolve the dispute in a way that no one else in the room will experience.

As the mediation progresses, the mediator will almost certainly gain insights into each side’s position that should not be shared directly with the other side. Nonetheless, that
information can help the mediator understand how a particular offer might be received. Similarly, the mediator might be able to help the parties better understand each other based on the mediator’s insights into each party’s motivations.

Advocates and parties employ various tactics in direct negotiations – including puffing, lying, bluffing and other kinds of theatrics. Before some of those same tactics are used in a mediation, the parties should consider their effect on the other side and the mediator. Mediators expect the parties to puff, bluff, and exaggerate. Lying to a mediator may have unforeseen consequences, however. If a party says, “We must have $100,000 in order to settle this case,” and then an hour later is calmly discussing countering the latest offer from the other side at less than $100,000, the mediator is then likely to discount that party’s later “non-negotiable” demands.

The parties should consider the mediator fair game for questions such as:

- “Are they bluffing?”
- “Where are they really? Their last offer seemed to go backwards.”
- “Will they accept $50,000?”
- “If we want to end up at $75,000, what should we offer next?”
- “If we offer X (and we aren’t offering X -- this is a hypothetical question), would the other side go to Y?”

The mediator also should be considered fair game to deliver messages such as, “We won’t respond to that offer. Go back, tell them to get real and maybe we can resolve this.” But do not be surprised if the mediator pushes back against taking that position to the other side. The mediator is trying to avoid hearing the five deadly words, “I won’t bid against myself.”

Mediators can try various mechanisms to avoid or overcome an impasse in bargaining. If the circumstances are right, perhaps the lawyers or principals should meet alone – often with the mediator, but with no one else. If the parties have been meeting separately with the mediator, the mediator might bring all the parties together to attempt to overcome a particular negotiation barrier. In other situations, the parties might agree to adjourn the session in order to think about the possibilities discussed during the day.

The parties might also ask the mediator for a proposal to resolve the dispute, or to offer both parties an objective evaluation of the likely court outcome. Both techniques have the potential downside of making the mediator less useful as a settlement broker after having delivered an opinion on the merits. If a mediator does offer a proposal for resolving the dispute, the general rule is that each party responds privately to the mediator as to whether it accepts the proposal. Unless both parties accept the proposal, the parties are told simply that the proposal was not acceptable. That way, the party that rejects the offer does not learn that the other side has set a new floor or ceiling for further negotiation. Also, if the parties get close enough, the mediator might suggest the inelegant, but often effective, tack of splitting the difference.
I. Settlement - The Role Of A Writing

If the parties do agree to settle during mediation, they have to memorialize their agreement. Unfortunately, mediations often end late in the evening when some participants are eager to catch the last flight out or get home to their families. The desire to leave should be resisted until some memorialization can take place. The gold standard would be a fully-drafted and executed settlement agreement. The gold standard often is not possible, however. When a full settlement agreement cannot be executed, the parties should draft and sign a term sheet capturing the essential terms of the parties’ agreement.

No universal law determines whether a term sheet is as enforceable as a full settlement agreement. Many mediators believe, however, that the greatest strength of a term sheet may be that it acts as a psychological barrier to participants who wake up convinced that the deal they struck the evening before is not a good one. Seeing one’s signature at the bottom of a clear term sheet tends to reduce next-day second-guessing.

If parties encounter difficulties moving from a term sheet to a formal agreement, they should re-engage the mediator sooner rather than later. Prompt intervention by a mediator can regain the momentum the parties had at the point of agreement and prevent escalation of a dispute over whether there was ever an agreement in the first place.

IV. SPECIAL CHALLENGES OF SYSTEMWIDE MEDIATION

Systemwide mediation presents special challenges of grouping, sequencing, and personal dynamics. Many mediators believe, however, that the greatest strength of a term sheet may be that it acts as a psychological barrier to participants who wake up convinced that the deal they struck the evening before is not a good one. Seeing one’s signature at the bottom of a clear term sheet tends to reduce next-day second-guessing.

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IV. SPECIAL CHALLENGES OF SYSTEMWIDE MEDIATION

Systemwide mediation presents special challenges of grouping, sequencing, and personal dynamics. Discussing these concepts is easier with a hypothetical. So assume for this discussion that (i) a franchisor and a franchisee are litigating a termination case where the franchisor is seeking past and future royalties, and the franchisee has filed a counterclaim that the termination was done in bad faith; (ii) in discovery the franchisee learns that the franchisor has been taking rebates on numerous products that the franchisees were required to buy from designated suppliers; and (iii) the franchisor has not disclosed in its prior UFOC’s or in its current FDD that it accepts rebates. The system’s 250 franchisees band together and hire a lawyer to represent them. Some want damages; some want rescission; some want other concessions; some want to punish the franchisor; others want a quick, fair resolution; others owe money to the franchisor or are close to default and would like to be relieved of their liabilities; and a handful are in litigation or are protesting recent terminations. The parties decide on mediation.

A mediator would first need to understand all the interests of the respective franchisees, and to group them into baskets. Some baskets are obvious, such as one for those seeking damages, another for those seeking rescission, and a third for those already in litigation. Other groupings require judgment. For example, should separate baskets exist for those who want to

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31 For a general discussion of multi-party mediation in a non-franchise setting, see James C. Freund, Three’s a Crowd—How to Resolve a Knotty Multi-Party Dispute Through Mediation, 64 Bus. Law. 359 (Feb. 2009).

32 A lawyer in this situation faces a host of ethical issues in representing clients with some interests in common and some that are not or that may even clash. Those issues can be further complicated if the attorney takes the matter for a contingency fee. A discussion of the ethical issues of this type of group representation is beyond the scope of this paper. A mediator, though, needs a sophisticated understanding of the benefits, tensions, and challenges that arise from the franchisee group’s having one counsel, and the possibility that new counsel may need to enter if conflicts become too acute for one counsel to represent all parties.
punish the franchisor and those who want a quick, fair resolution? What about for those protesting recent terminations?

The mediator then needs to make sure that the franchisee group has clear communication channels. Will the franchisee group have a decision committee? Will each basket have its own decision committee? Who will have authority to negotiate? Who will have authority to bind? If, however, beginning the mediation process is put off until all these issues are definitively resolved, a vital opportunity to settle the case may be lost. Initially, the mediator may simply look for communication lines that are good enough to begin moving the matter forward.

Once the communication lines are set up, the mediator needs to probe each basket’s interest further in terms of business issues and personalities. The mediator also needs to explore resolution issues with the franchisor. Once the mediator understands the basic issues and the personalities, the mediator needs to decide whether to sequence discussions or whether to address all issues simultaneously. For example, in our hypothetical, should the first step be an audit of the rebates by a mutually-selected auditor? Once the information is gathered, should the mediator sequence discussions to deal first with the basket seeking damages, then turn to the rescission group, and finally to the suit related to termination?

After making the sequencing decisions, the mediator needs to decide whether to continue shuttle diplomacy or whether to schedule an actual mediation session. At some point, shuttle diplomacy loses its effectiveness. Scheduling is difficult. Parties stall and delay. No one faces up to the need to make decisions.

Given these drawbacks, the mediator should move to a formal mediation session as soon as the mediator finishes the preliminary issue and interest identification and the necessary information exchange. By this time, the communication/authority protocol for each franchisee basket needs to be set reasonably firmly so that binding decisions can be made and the decision makers will be present at the mediation session. The session itself needs to be highly structured or it can become chaotic and counterproductive. Sufficient time needs to be set aside as multi-party mediation often requires an initial 2- or 3-day session to make progress.

After the initial session, the mediator will likely face new sequencing decisions. The mediator needs to communicate these decisions clearly to all parties so that no basket feels it is being ignored or sacrificed. So long as all the parties continue to trust the mediator, the mediator can then focus on resolving each basket on its own terms or can seek to nail down universal terms that would apply to all franchisees.

V. DEAL MEDIATION

Until now, we have been discussing mediation as a tool to resolve business disputes. Another use for mediation is deal mediation, which means using a mediator to help prepare for a deal, negotiate the deal, or mend a post-deal relationship that no longer works. The term “mediation” may be an awkward fit here, and perhaps negotiation facilitator, agreement facilitator, or relationship facilitator would fit better. But the skills applied are similar to those used in dispute resolution mediation, and the benefits of deal mediation are similar to those of dispute mediation.

33 This section is adapted from Peter Silverman, A Client’s Guide to Mediation and Arbitration 65-69 (A.B.A. 2008).
A. Why Use A Deal Mediator?

A business deal has a different dynamic from a business dispute. With a deal, each business needs to benefit for the deal to happen. Otherwise, the parties simply choose to part and go their own way. There is no dispute that the parties must either resolve or do battle. Also, business executives and attorneys have developed well-honed negotiation skills for making deals happen. So why would they seek assistance from a deal mediator?

The driver for seeking mediation assistance is that some of the key challenges in negotiating a deal are similar to the challenges in resolving a dispute. Issues arise because of emotions, ego, past dealings, outside pressures, and differing communication styles. Negotiators get stuck on specific positions rather than focusing on their overall interests or thinking afresh about offering different options. Negotiators become cautious in deciding how much information to disclose and when to disclose it, whether and when to make concessions, and how deep the concessions should be. In all these instances, a deal mediator can help overcome obstacles to move the negotiation forward.

A deal mediator can also help make the deal better. Negotiators often end up in a seesaw pattern of concessions, and fail to take a step back to see if new options may benefit the parties more than the compromise position. The deal mediator may be able to step back and analyze whether, with all the compromises that were struck, the deal is sustainable over the long term. If sustainability issues exist, the deal mediator can suggest ways to refashion the deal so as to avoid the obstacles that the parties inadvertently created in their compromises. Finally, direct negotiations can often harm personal relationships between the parties. If parties do not address and resolve these issues, they can fester and lead to problems down the road when the parties need good faith and respect to deal with obstacles that arise in executing any deal. A deal mediator can help the parties confront and resolve personal animosities that arise from negotiation.

B. The Deal Mediator's Roles

Deal mediators can be used effectively at different stages in the life cycle of a deal: before negotiations begin, at any time during the negotiation, or after the deal is made and troubles have arisen. Each stage requires the mediator to assume a different role.

Before negotiations begin, a deal mediator can help establish a process for the negotiations. This may be particularly helpful where more than one party is involved, or where a number of parallel negotiations need to occur as part of the agreement. For example, if a holding company is purchasing a new franchise system, different groups from each business may need to negotiate issues related to technology, human resources, and logistics, and these may need to be scheduled sequentially or contemporaneously with the primary negotiations. Or disagreements may exist over which issues should be addressed or resolved first. The deal mediator can help frame the issues and suggest the best way to address them.

During negotiations, the deal mediator can play a number of roles. The mediator could be present the entire time to facilitate the negotiations. Or the mediator could be called in to address one or a group of issues on which the parties are stalemated or on which they need help brainstorming new options. Another role for a mediator may be intervening to bring the parties back on track after tempers have flared.
A deal mediator brought in during negotiations can also help parties decide when not to proceed with the deal. The deal mediator helps to make sure that the parties have shared with each other all the information they should reasonably share, and that each party clearly understands the other party’s positions and interests. If that has been done, parties then have the information they need to make the decision whether to proceed, and they do so without their decision being guided by miscommunication or misunderstanding.

Finally, after agreement is reached and the parties begin carrying out the deal, a deal mediator can be called in if problems arise. A deal mediator who was involved in the negotiations will have an independent and objective view of the negotiations and the ultimate agreement, and will also know the parties and the dynamics. The deal mediator may be able to help the parties resolve the problem or agree on improvements to the agreement that are consistent with each party’s interest and that take into account developments that the parties had not foreseen.

VI. ETHICAL ISSUES

A. Mediator Ethics

In 2005, the American Bar Association (ABA), American Arbitration Association (AAA) and Association for Conflict Resolution (ACR) adopted a new Model Set of Standards for Mediators (the “Model Standards”). The Model Standards supersede the standards the same organizations adopted in 1994.

Whether mediators should consider the Standards binding is not yet resolved. The prefatory language in the Model Standards states that the Standards: “unless and until adopted by a court or other regulatory authority do not have the force of law.” The same paragraph, though, also states “Nonetheless, the fact that these Standards have been adopted by the respective sponsoring entities, should alert mediators to the fact that the Standards might be viewed as establishing a standard of care for mediators.” As a matter of practice, mediators generally seek to comply with the Model Standards, and advocates should be familiar with them as a tool to enhance mediation advocacy.

Each of the nine Standards is set out broadly and then has subparts that amplify the Standard. The Standards are:

- **Standard I** Self-determination: A mediator shall conduct a mediation based on the principle of party self-determination.

- **Standard II** Impartiality: A mediator shall decline a mediation if the mediator cannot conduct it in an impartial manner.

- **Standard III** Conflicts of interest: A mediator shall avoid a conflict of interest or the appearance of a conflict of interest during and after a mediation.

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Standard IV Competence: A mediator shall mediate only when the mediator has the necessary competence to satisfy the reasonable expectations of the parties.

Standard V Confidentiality: A mediator shall maintain the confidentiality of all information obtained by the mediator in mediation, unless otherwise agreed to by the parties or required by applicable law.

Standard VI Quality of the Process: A mediator shall conduct a mediation in accordance with these Standards and in a manner that promotes diligence, timeliness, safety, presence of the appropriate participants, party participation, procedural fairness, party competency and mutual respect among all participants.

Standard VII Advertising and Solicitation: A mediator shall be truthful and not misleading when advertising, soliciting or otherwise communicating the mediator's qualifications, experience, services and fees.

Standard VIII Fees and Other Charges: A mediator shall provide each party or each party's representative true and complete information about mediation fees, expenses and any actual or potential charges that may be incurred in connection with a mediation.

Standard IX Advancement of Mediation Practice: A mediator should act in a manner that advances the practice of mediation.

On a surface reading, the standards are reasonably clear and sensible standing alone or read together. On a closer reading, though, questions and inconsistencies arise.

A simple example is that Standard I provides for self-determination of the parties, but one of the subparts under Standard VIII prevents the parties from basing the mediator's fees on a contingency agreement. Thus the Standards limit self-determination by preventing even sophisticated parties, acting with their lawyers' advice, from providing the mediator with an incentive-based fee arrangement.

Another inconsistency arises in terms of the mediator's approach to the mediation. The Standards appear to reflect a preference for pure facilitative mediation, in which the mediator helps the parties identify their interests, think about all options clearly, separate out personality and emotional concerns, and then decide freely whether they wish to resolve their dispute and on what terms. Thus Standard VII counsels the mediator to promote procedural fairness, party competency, and mutual respect among all participants. Similarly, Standard I supports this preference with its principle of self-determination.

35 Standard VIII(B)(1), "A mediator should not enter into a fee agreement which is contingent upon the result of the mediation or amount of the settlement."
But the principle of self-determination also leads to an inconsistency. Business disputants may want the mediator to be forceful, evaluate each side’s positions critically, press both sides hard using all the tools in the negotiation toolbox, and drive both parties to settle. The parties may not care about whether the mediator is scrupulous with procedural fairness or whether the parties have mutual respect. If that is the approach the parties want, may the mediator ethically follow that approach under the Standards? As a matter of practice, and regardless of whether they deliberately consider the Model Standards, most mediators approach mediation with the process the parties want, which often includes the effort to assertively guide the parties toward settlement.

Recently, the ABA Section of Dispute Resolution created a Committee on Ethical Guidance to provide guidance to mediators on the Model Standards. Having adopted operational guidelines in 2007, the Committee has issued seven opinions as of mid-July, 2009. The opinions address a number of issues including confidentiality, mediation cost-sharing agreements, and whether the mediator may ask counsel, outside the presence of their clients, to reduce their fees to bridge a settlement gap. Another resource for ethics guidance is the ABA ADR Section’s National Clearinghouse for Mediator Ethics Opinions, which has gathered ethics opinions for mediators from 43 states, and has made them available on the internet.

One practical ethical question worth noting is, if the mediation fails to resolve all issues and the parties then want the mediator to serve as an arbitrator for the remaining issues, may the mediator ethically do so? The Model Standards appear to permit the mediator to assume the role of an arbitrator if the parties give informed consent. The Model Standards, however, provide no guidance as to whether mediators should do so. In making that decision, mediators need to think through clearly whether they can render an impartial decision given what they have learned at the mediation and the relationship they have developed with the parties. Mediators also have to be sure that the parties’ consent is truly informed, which at minimum should require that the parties are represented by experienced counsel and are aware of the challenges the mediator faces in weighing the evidence at arbitration coupled with the knowledge and views the mediator developed during the mediation.

B. Attorney And Party Ethics*

1. Lying, Puffing And Bluffing

The scope and application of the restraints that ethics requirements place on the freedom of attorneys to lie, puff, and bluff during mediation and negotiation have long been the

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36 http://www.abanet.org/dch/committee.cfm?com=DR018600
37 Id.
38 The mediator may ethically do so. “However, the mediator must be sensitive when dealing with this delicate subject....” SODR 2009-1, http://meetings.abanet.org/webupload/commupload/DR018600/relatedresources/SODR_2009_1.pdf.
39 www.abanet.org/ethics/dispute/Pages/default.aspx
40 Standard VI.A.8
subject of heated debate. Under Rule 4.1 of the ABA’s Model Rules of Professional Conduct, lawyers are instructed:

In the course of representing a client a lawyer shall not knowingly:

(a) make a false statement of material fact or law to a third person; or

(b) fail to disclose a material fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.

In addition, Model Rule 8.4(c) prohibits attorneys from engaging in “conduct involving dishonesty, fraud, deceit or misrepresentation,” and Model Rule 3.3 prohibits making “a false statement of fact or law to a tribunal.” On their face, these rules might seem to prohibit any lying, puffing or bluffing during the mediation process. The problem is that, owing to “the depth of the tensions among competing moral considerations” involved in negotiation, settlement discussions have not been conducted that way from the time to which the mind of man runneth not.

In 2006, the American Bar Association’s Standing Committee on Ethics and Professional Responsibility tried to come to grips with the issue in a Formal Opinion entitled Lawyer’s Obligation of Truthfulness When Representing a Client in Negotiation: Application to Caucused Mediation. The Opinion’s summary conclusion is as follows:

* The authors wish to thank Brianna M. Mooty, a summer associate at Gray Plant Mooty in Minneapolis, Minnesota, for her assistance in researching this section of the paper.


42 Burns, supra note 33.

44 ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 06-439 (2006). The Opinion interprets the ABA Model Rules. As noted in the Opinion, it is not the Model Rules but the actual “laws, court rules, regulations, rules of professional conduct, and opinions promulgated in the individual jurisdictions” that are controlling. Id. at n.1.
Under Model Rule 4.1, in the context of a negotiation, including a caucused mediation, a lawyer representing a client may not make a false statement of material fact to a third person. However, statements regarding a party’s negotiating goals or its willingness to compromise, as well as statements that can fairly be characterized as negotiation “puffing,” ordinarily are not considered “false statements of material fact” within the meaning of the Model Rules.

Needless to say, there is a good deal of gray in that statement.

a. **Prohibited Conduct Under Rule 4.1**

It is easier to begin with what a lawyer cannot do in mediation. Rule 4.1(a) prohibits an attorney from “knowingly” making a “false statement of material fact.” Application of that prohibition hinges on the meaning of the two crucial quoted terms: first, the statement must be made “knowingly;” second, the statement must be of “material fact.” The ABA Model Rules define “knowingly” as requiring actual knowledge that the statement is false, although that knowledge can be inferred based on the facts of the situation. As for the definition of “material fact,” the annotation to the Model Rules provides that “[a] statement is material for the purposes of Rule 4.1(a) if it could have influenced the hearer,” and “[w]hether it actually did influence the hearer is beside the point.”

The United States District Court for the District of Maryland expanded on this definition in *Ausherman v. Bank of America*, stating that a material fact in settlement discussions is one that “reasonably may be viewed as important to a fair understanding of what is being given up, and, in return, gained in the settlement.” In discussing the materiality of specific statements made in the course of mediation, courts have found that the death of a client and the amount or availability of insurance coverage for the claim at issue are both “material facts” that a lawyer must disclose where circumstances warrant.

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45 Of the three rules mentioned above, application of Model Rule 4.1 is the most critical. Rule 3.3 is limited to misrepresentation before a tribunal, and thus, for present purposes, is most likely to be applicable only when a judge or magistrate judge becomes involved in court-supervised mediations. Although Rule 8.4(c) appears to be the most comprehensive prohibition on misrepresentations, the ABA has advised that Rule 8.4(c) does not “require a greater degree of truthfulness than does Rule 4.1.” *Id.* at 2, n.2. Therefore, we focus on what is prohibited and allowed under Rule 4.1.

46 *Model Rules of Prof'l Conduct R. 1.0(f).*

47 *Id.* at R. 4.1 annot. (citing *In re Merkel*, 138 P.3d 847 (Or. 2006)).


49 *Id.* at 449.


51 Cronin-Harris, supra note 41 (citing *Slotkin v. Citizens Casualty Co. of New York*, 614 F.2d 301 (2d Cir. 1979); and *Crowe v. Smith*, 151 F.3d 217 (5th Cir. 1998)).
That guidance is helpful if the issue is disclosure of the death of a client or the amount of
insurance coverage, but how the principle applies in other situations is not always clear cut. 52
The ABA’s 2006 opinion advises:

[A] false statement of material fact would be a lawyer representing an employer in labor
negotiations stating to union lawyers that adding a particular employee benefit will cost
the company an additional $100 per employee, when the lawyer knows that it actually
will cost only $20 per employee.53

On the other hand, saying that a benefit would be “far too costly” for the company would likely
pass muster. Thus, the ethical rules for mediation appear to push lawyers toward
generalizations and away from specific statements of fact or exact dollar figures, unless the
lawyer is prepared to be held to exactly what he or she says.

Rule 4.1(b) requires disclosure of a material fact “when disclosure is necessary to avoid
assisting a criminal or fraudulent act by a client.” Where fraudulent or criminal conduct was
obvious, as where a lawyer silently allowed a client to embezzle funds through negotiations,
courts have usually found that disclosure was required.54 When the conduct is less obviously
wrongful, however, the courts are less predictable.

In Hamilton v. Harper,55 for example, the plaintiff was negotiating with an insurance
carrier who had filed a declaratory judgment action contesting coverage after denying the claim.
After the plaintiff received a settlement offer, his counsel learned that the court had granted the
insurer’s motion for summary judgment and immediately accepted the offer. When the court
vacated the settlement on other grounds, it noted that it took “a particularly dim view” of the
“attorney’s failure to disclose his knowledge regarding the action taken by the court.” This case,
however, does not seem clearly distinguishable from Duguay v. Great Atlantic & Pacific Tea
Company,56 where the court held that an attorney had no duty to disclose the fact that a letter
containing an offer of judgment for $10,000 was being mailed to the petitioner during a
settlement conference. In that case, the petitioner settled for only $6,000 during the conference,
then later tried to rescind the settlement after receiving the letter. The court did not allow
rescission.

b. Allowed Conduct Under Rule 4.1

The ABA also provides guidance on what constitutes affirmatively allowable conduct in
mediation. Comment 2 to Rule 4.1 states that, “[u]nder generally accepted conventions in
negotiation,” statements such as “[e]stimates of price or value placed on the subject of a
transaction and a party’s intentions as to an acceptable settlement of a claim” are not
considered statements of material fact. ABA Formal Opinion 06-439 similarly indicates that
these types of statements are generally allowed even if they might convey a false impression:

52 See Freedman, supra note 41.
54 In re Potts, 2007 Mt. 81 (Mont. 2007) (citing an attorney who remained silent when a client was converting funds
belonging to a probate estate); see also Kath v. Western Media, 684 P.2d 98 (Wy. 1984) (holding that counsel had a
duty to disclose critical correspondence when he knew key witness testimony was probably false).
A buyer of products or services might overstate its confidence in the availability of alternate sources of supply to reduce the appearance of dependence upon the supplier with which it is negotiating. Such remarks, often characterized as “posturing” or “puffing,” are statements upon which parties to a negotiation ordinarily would not be expected justifiably to rely, and must be distinguished from false statements of material fact.\footnote{ABA Comm. on Ethics and Prof’l Responsibility, Formal Op. 06-439 at 2 (2006).}

Nonetheless, “puffery” can sometimes cross the line and become misrepresentation of a material fact. The ABA Opinion gives the following example: a lawyer can ethically state in a negotiation that the client does not wish to settle for more than $50, even if the Board of Directors has authorized a higher settlement figure. The attorney cannot, however, “state that the Board of Directors had formally disapproved any settlement in excess of $50” when there was authorization to settle for a higher figure. Thus, what may seem like semantics can play an important role in staying on the right side of the ethical line in mediations.

When what happened in a mediation ends up in the courts, judges sometimes ask attorneys to disclose information about the mediation discussions, including their client’s settlement position. While the ABA has questioned the propriety of such an inquiry from a judge -- observing that attorneys can sometimes ethically refuse to answer these questions -- the ABA still considers a client’s ultimate settlement position to be a material fact.\footnote{ABA Comm. on Ethics and Prof’l Responsibility, Formal Op. 06-439 at 7-8, nn.19-22.} So, if asked to reveal the client’s “bottom-line” information to a judge, the attorney cannot lie or engage in any kind of misrepresentation in response to the inquiry.

Some question has been raised as to whether these rules on puffery apply to mediation in addition to negotiation, and if so, whether they apply to all forms of mediation. Specifically, some practitioners and commentators have argued that there should be greater, or lesser, requirements of honesty in caucused mediation compared to mediation where the mediator only facilitates direct party negotiations.\footnote{Id. at 8.} The ABA has rejected these arguments, clearly stating that the requirements are the same for negotiation, caucused mediation, and mediator-facilitated direct negotiation.\footnote{Duguay, supra note 56.}

In addition to engaging in puffery, attorneys may ethically withhold information from the other side under a variety of circumstances.\footnote{See Duguay, supra note 56; Statewide Grievance Committee v. Gillis, 2004 Conn. Super. LEXIS 340 (Conn. Super. 2004) (finding no duty to disclose to an insurance carrier that client had suffered from another accident prior to the accident for which the client was making a claim, even though the client had been diagnosed as five percent permanently disabled after the first accident). But see Nebraska v. Addison, 412 N.W.2d 855, 857 (Neb. 1987) (finding attorney’s failure to correct opponent’s impression that there was $150,000 of insurance when there was really $1 million in insurance coverage rose to the level of fraudulent representation).} Generally, courts have found no duty to correct an adversary’s misimpressions.\footnote{See Duguay, supra note 56; Statewide Grievance Committee v. Gillis, 2004 Conn. Super. LEXIS 340 (Conn. Super. 2004) (finding no duty to disclose to an insurance carrier that client had suffered from another accident prior to the accident for which the client was making a claim, even though the client had been diagnosed as five percent permanently disabled after the first accident). But see Nebraska v. Addison, 412 N.W.2d 855, 857 (Neb. 1987) (finding attorney’s failure to correct opponent’s impression that there was $150,000 of insurance when there was really $1 million in insurance coverage rose to the level of fraudulent representation).} Likewise, ABA Formal Opinion 94-397 advises that an attorney is not obligated to inform the other party that the statute of limitations has run on the
other party’s claim, though the attorney is prohibited from making an affirmative representation to the contrary.

In *Spaulding v. Zimmerman*, however, the court added a cautionary restriction on when an attorney may withhold information. There the defendant’s counsel discovered through their own medical examinations that an injured child who was the subject of a personal injury case was suffering from a potentially fatal aneurysm. Due to the pendency of settlement discussions, defendant’s counsel did not reveal this information to the child or his parents. In later litigation over counsel’s failure to reveal this information, the court held that defense counsel was not required to disclose that information when negotiating as an adversary, but was required to disclose the additional injuries when asking the court to approve the settlement.

### 2. The Requirement To Mediate In “Good Faith”

In addition to guidance provided by the Model Rules, the ABA Ethics Committee and their state counterparts, most state and federal laws on the subject require that attorneys act in good faith during mediation. Although none of the statutes requiring good faith actually define what that means (and there are at least 100 such state and federal statutes), several definitions have been offered by commentators. Good faith is often more easily defined and understood in the negative, through defining “bad faith” conduct. Bad faith conduct in mediation has been defined as using “the mediation process primarily to gain strategic advantage in the litigation process; use[ing] mediation to impose hardship rather than to promote understanding and conflict resolution; or neglect[ing] an affirmative material obligation owed to another participant, the mediator, or the court.”

There is little case law discussing the issue of good faith in mediation, and nearly all that there is involves court-ordered mediation. These cases have been said to fall into four categories:

1. those involving alleged bad faith failure to comply with procedural requirements of mediation; (2) those involving alleged failures to bargain in good faith (purely subjective); (3) those involving the failure to bring a representative with “sufficient” settlement authority; . . . and, (4) those involving allegations of multiple forms of bad faith. Generally, courts have been receptive to claims of bad faith in the first category. At the appellate level, at least, very few cases in the second category have resulted in sanctions. Courts are divided as to those in the third and fourth category.

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65 See Kimberlee K. Kovach, *Good Faith in Mediation—Requested, Recommended, or Required? A New Ethic*, 38 S. Tex. L. Rev. 575, 622-23 (1997) (for a definition of good faith and an itemization of behavior that could be considered good faith).


67 Id. at 380.
a. **Failure To Attend Mediation**

The procedural issues that have led to litigation most frequently involve a failure to attend a court-ordered mediation or to complete required pre-mediation paperwork. In *Roberts v. Rose*, an attorney had a conflict with a scheduled mediation session, and he communicated that fact but took no steps to ensure that the mediation was rescheduled. The appeals court upheld sanctions against the attorney.

b. **Failure To Make Reasonable Compromises**

Cases involving allegations of bad faith bargaining are more difficult because they require the court to form a judgment regarding a party’s state of mind. These cases are also ethically problematic, because the inquiry can directly conflict with the ethical rules governing confidentiality. In some cases, courts have called witnesses and taken testimony to determine the parties’ good faith in adopting certain positions. Most courts, however, have been reluctant to do so. The California Supreme Court, for example, overturned a policy-based exception to the confidentiality of mediations that allowed disclosure when it was necessary to determine whether a party had acted in bad faith. The court held that parties could testify only about non-communicative conduct that occurred during the mediation — all communicative conduct was held protected. Federal courts also tend to reject such inquiries, finding them inconsistent with the confidentiality necessary for mediation to succeed.

If the party representatives attending a mediation lack sufficient authority or desire to settle, the process is undermined from the outset. In many cases involving court-ordered mediation, judges have sought to overcome this problem by requiring that each side send a representative with complete authority to settle the case. In some cases, even sending a client representative with authority to settle up to a certain amount with permission to call to get more authority was held insufficient. This can be problematic and costly for corporations where no one individual has complete authority to settle a particular case. Courts have ordered sanctions

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69 Id. at 34.

70 See, e.g., *Hunt v. Woods*, 1996 U.S. App. LEXIS 1420, at *8-9 (6th Cir. 1996) (taking testimony from the mediator and reviewing the defendant’s refusal to make an settlement offer before finding that the defendant acted in good faith). The court itself can also serve as a witness. In *Texas Dept. of Trans. v. Pirtle*, 977 S.W.2d 657 (Tex. App. 1992), the court assessed all costs including mediator and attorney fees against the defendant, stating that “they pretty much told me from the beginning they weren’t going to mediate . . . ” Id. at 658. *But see Graham v. Baker*, 477 N.W.2d 397 (Iowa 1989) (refusing to issue sanctions in a case where the defendant attended the mediation but whose actions “ranged between acrimony and truculency,” finding that the defendant’s attendance met the minimum participation required by the statute).


72 Id. See also *Texas Parks and Wildlife Dept. v. Davis*, 988 S.W.2d 370, 375 (Tex. App. 1999) (court cannot inquire into the manner in which parties negotiate in mediation).


in more egregious situations, such as where a party sent a representative who had no knowledge of the case and minimal authority to settle.\textsuperscript{75}

c. Some Potential Undesirable Consequences Of Imposing Sanctions For “Bad Faith” Mediation

While the resolution of disputes through mediation is desirable for many reasons, negative consequences can arise from judicial punishment for “bad faith” behavior in mediation. These consequences can include undermining the confidentiality of mediation through inquiries into subjective bad faith; encouragement of ancillary litigation; a chill on expression during mediation resulting from the fear of allegations of bad faith and sanctions; and a loss of party autonomy that is essential to effective mediation.\textsuperscript{76}

Although mediation can be an effective tool in reaching settlement and reducing costs, parties also have the right to go to trial, which, intrinsically, includes the right not to settle their case. There are many legitimate reasons why a party may refuse to settle a particular case. Moreover, mediation is now often required by franchise agreements or court rules or orders. Once a party cannot walk away and the potential for court sanctions is introduced,\textsuperscript{77} parties may feel coerced to settle or to make offers that they would not make without coercion. Some commentators have suggested that forcing settlement under these circumstances is a perversion of the mediation process.\textsuperscript{78}

VII. NEW TRENDS: COLLABORATIVE/COOPERATIVE LAW*

Mediation has become a powerful tool for resolving disputes for three reasons. The first is that the process works. The second is that the marketplace is demanding dispute resolution that is quicker and cheaper, but fair. Thus trial lawyers have learned to be as much statesmen as they are soldiers. Third, the legal and business communities have comprehensively developed the mediation infrastructure and toolbox: skilled, experienced, well-trained mediators; lawyers skilled in mediation advocacy; businesses knowledgeable about mediation and how it saves cost and helps preserve relationships; a rich literature of research and practical advice; and numerous non-profit organizations promoting mediation and offering mediation services.

Other processes are percolating that may enhance parties’ ability to resolve their legal disputes cheaper and quicker, yet fairly. One such process is collaborative law, which is now actively practiced in family law disputes. The key to the process is that parties hire lawyers who have subscribed to the collaborative law process and are trained in its principles of cooperative


\textsuperscript{76} Carter, supra note 66, at 391-396.

\textsuperscript{77} In pre-trial mediation conferences, the federal courts have power to issues sanctions under Fed. R. Civ. P. 16. Many states have adopted similar rules.

\textsuperscript{78} For a more detailed discussion of this argument, see Cronin-Harris, supra note 41.

*The authors would like to thank Rob Melching, a summer associate at Shumaker, Loop & Kendrick for his assistance in research for this section.
negotiating. The parties and the lawyers sign what is known as a four-way agreement, which provides that the lawyers’ and clients’ sole focus is to use cooperative principles to resolve the dispute. If the parties do not resolve their dispute and either party wants to proceed to litigation, the lawyers must resign and the parties must obtain new counsel.

A variation on this process is referred to as cooperative law. The difference is that while the parties initially pursue settlement using the same cooperative negotiation principles, they do not sign a four-way agreement and the lawyers do not need to resign if the parties later choose to litigate.

Another related concept is the notion of hiring settlement counsel. Settlement counsel would not necessarily need to subscribe to cooperative negotiation principles, but their sole goal would be to resolve the dispute. And if the dispute went to litigation, other counsel would be hired.

These procedures raise a host of issues. One is ethical. If counsel’s only goal is to resolve the dispute, is counsel abandoning the duty to zealously advocate the client’s interests? As a general matter, the American Bar Association and state bar associations and legislatures are finding that the ethics rule allow practicing collaborative law in the family law area with informed consent from clients. No particular differences appear that would distinguish business from family law in terms of extending the reasoning in these opinions to approve collaborative and cooperative law in business disputes. If anything, businesses are more sophisticated users of legal services than are spouses undergoing a divorce, and are more capable of consenting to the process and understanding the ramifications of hiring counsel for a specific purpose that may be contrary to zealous advocacy as it has been traditionally understood.

Other issues are practical. While the processes have worked in family law disputes, will they work in business disputes? No clear answer has emerged, and the process is in its infancy in being applied to business disputes. One obstacle is that collaborative law’s

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79 See generally John Lande, Possibilities for Collaborative Law: Ethics and Practice of Lawyer Disqualification and Process Control in a New Model of Lawyering, 64 Ohio St. L.J. 1315 (2003) [hereinafter Possibilities]


82 See generally Possibilities, supra note 71, at 1330-1372.

83 Ethics committees in Kentucky, Minnesota, Missouri, New Jersey, North Carolina, and Pennsylvania have found that collaborative law complies with their ethical codes. The state legislatures of California, North Carolina, and Texas have codified the practice. The ABA Standing Committee on Ethics and Professional Responsibility in Formal Opinion 447 found that the practice does not violate any ethical requirements. Colorado’s Ethics Committee has found that collaborative law creates a per se conflict. See discussion in Scott R. Peppet, The (New) Ethics of Collaborative Law, 14 Disp. Resol. Mag. 23 (Winter 2008).

disqualification requirement could pose barriers to the way business traditionally uses its litigation counsel. Still, those traditions can change just as they changed in family law. Further, cooperative law principles do not require disqualification if the parties do not settle. Thus cooperative law, or some variation on it, may be more suitable for business disputes.

For example, in franchise disputes, franchisors and franchisees often use their long-term counsel who knows the franchisor’s or franchisee’s business, values, and approach to disputes. These franchisors would not likely be attracted to a process where their long-time counsel would have to disqualify itself if the parties did not settle a dispute and it proceeded to litigation. Franchisors, however, may be willing to consider retaining special settlement counsel because over time settlement counsel would learn the franchisor’s business, values and approaches to dispute resolution. Franchisees, however, do not have regular disputes to address, and thus would be less inclined to develop this type of relationship with separate settlement counsel.

A related practical issue is whether, if counsel’s only role is to settle, will counsel (intentionally or not) be biased toward encouraging the client to settle by overemphasizing the upside of settling and the downside to litigation? This issue should resolve itself. The business marketplace is sophisticated enough to understand this dynamic, and businesses will choose to hire collaborative or cooperative lawyers only if the businesses believe that doing so is in their best interest. They will understand the potential for bias just as they now understand that some attorneys may be biased toward litigation because litigation is lucrative for lawyers while early settlement is not.

Another issue relates to the toolbox and infrastructure for collaborative and cooperative negotiation. Most business trial lawyers are only vaguely aware of these concepts. And since a mediator is not involved in collaborative or cooperative negotiation, skilled lawyers are solely responsible for the success of the process. Thus, a good deal of training will be necessary to jumpstart using collaborative or cooperative negotiation to resolve business disputes.

Further, the organizational support for promoting collaborative and cooperative law has not yet developed in the sector that serves lawyers and businesses in business-related dispute resolution. The literature is scant and no major non-profit dispute resolution organization is promoting the process to the business community. And since collaborative and cooperative negotiation are not administered, the administering organizations like AAA and CPR may not have an economic incentive in promoting collaborative or cooperative law.

The marketplace will likely determine whether support networks for collaborative and cooperative law develop. If the process works, businesses will begin to use it and lawyers will begin to market the service. As (and if) demand grows, support networks will grow along with it just as they have in the family law field. As to how this might develop in franchising, certain franchisors may publicly commit to cooperative law negotiation principles and either train their in-house staff in the principles or require their outside counsel to undergo the training. Franchisee associations, the IFA, and the Forum may likewise offer the training. If parties begin


successfully resolving disputes early by using cooperative negotiation principles, the process could grow as mediation has.

The formal cooperative movement will likely extend beyond the dispute resolution process to the conduct of litigation itself. Organizations like the Sedona Conference are developing best practices cooperative principles for certain contentious areas of litigation like e-discovery\(^{87}\), and are developing principles of cooperation in discovery generally.\(^{88}\) Clients looking for speed and efficiency in resolving disputes will likely be demanding that their counsel be skilled in applying these new approaches to trial and arbitration.

VIII. CONCLUSION

As a closing thought, the notion of developing cooperative dispute resolution procedures lends itself well to the franchise area. We have a well-defined group of businesses (franchisors and franchisees and service providers to these industries), active trade associations, and through the Forum on Franchising we have a well-defined group of lawyers skilled in franchise law. The franchise industry is relationship-based, which increases the demand for relationship-friendly dispute resolution. And the increasing economic demand for faster and cheaper, yet fair, dispute resolution affects the franchise industry as much as any other. Those factors have helped make mediation a powerful process for resolving franchise disputes. The Forum and the franchise business community may have the opportunity together to address how to enhance the effectiveness of mediation, and how to develop new processes that will further advance the goal of quick and inexpensive, yet fair, resolution of franchise disputes.


\(^{88}\) The Sedona Conference Cooperation Proclamation (July, 2008), http://www.thesedonaconference.org/content/tsc_cooperation_proclamation/proclamation.pdf.
Biographies

Michael K. Lewis

Michael K. Lewis, a neutral with JAMS’ Washington office, is a mediator, arbitrator, teacher, and lawyer. Mr. Lewis has mediated a variety of disputes involving commercial, franchise, environmental, public policy, employment and interpersonal issues. He has worked in a variety of settings, including the Ford Motor Company, the 3M Company, the International Monetary Fund and the US Federal Deposit Insurance Corporation. Mr. Lewis taught negotiation at Georgetown University Law Center and currently teaches mediation in the Harvard Negotiation Institute. He served on the Council of the American Bar Association Section on Dispute Resolution, and is a member of the CPR International Institute for Conflict Prevention and Resolution’s Panel of Distinguished Neutrals. He currently is on the boards of the Consensus Building Institute and Search for Common Ground. Mr. Lewis has a bachelor’s degree in government from Dartmouth College and a law degree from Georgetown University Law Center.
Mr. Silverman is a trial lawyer, arbitrator and mediator, and has been recognized by Best Lawyers, Super Lawyers, and Franchise Times Legal Eagles for his excellence in those fields. He has served as a mediator and arbitrator for over 20 years. In his franchise practice, he represents franchisors, franchisees, and franchisee associations in lawsuits, arbitration, and mediation across the country. He is admitted to practice in Ohio, Michigan, and New York.

Mr. Silverman is a member of the AAA’s national roster of neutrals, and serves on the Northern District of Ohio’s Panel of Neutrals. He lectures frequently on ADR subjects and is the author of *The Client’s Guide to Mediation and Arbitration: The Strategy for Winning* (American Bar Association 2008), which is one of the ABA’s best-selling books. He is a member of the Litigation and Alternative Dispute Resolution Committee of the ABA Forum on Franchising, and is a member of the IFA/CPR Franchise Mediation Program Steering Committee.

Mr. Silverman is a partner in the Toledo, Ohio office of Shumaker, Loop & Kendrick. He received his law degree from the University of Michigan in 1981.
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Mr. Klarfeld is a Principal in the Washington, D.C. office of Gray Plant Mooty, where he specializes in franchise litigation and counseling. He has appeared as trial counsel for some of the country’s largest franchisors in courts, arbitrations and mediations across the United States, and as an arbitrator in international arbitration. He currently serves on the Governing Committee of the American Bar Association Forum on Franchising and as the Forum’s Membership Officer. He was the Editor-In-chief and a co-author of the first edition of *Covenants Against Competition In Franchise Agreements* (ABA 1992) and served in the same capacity for the second edition of that work, published in 2003. He is the author of numerous articles concerning franchise litigation and arbitration issues and was the co-author of the manual *Franchise Litigation* (Federal Publications, 1996).

Mr. Klarfeld has been in the private practice of franchise law for over 30 years. Prior to entering private practice, he served for two years as an Attorney/Advisor in the Office of Legal Counsel of the United States Department of Justice. He is a member of the Virginia and District of Columbia bars and of the bars of numerous federal trial and appellate courts.

Mr. Klarfeld received a Master’s degree from the University of Chicago and his law degree from the University of Virginia Law School, where he was a member of the Virginia Law Review and the Order of the Coif. After graduation from law school, he served as law clerk to the Honorable Robert R. Merhige, Jr., United States District Judge for the Eastern District of Virginia.