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Transactional Mediation: Using Mediators in Deals

by Scott Peppet

This column is sponsored by the CBA Alternative Dispute Resolution Committee. The articles printed here describe recent developments in the evolving field of ADR, with a particular focus on issues affecting Colorado attorneys and ADR providers.

This article addresses whether third-party mediators could be helpful in deal-making, just as they are in resolving disputes. It makes a theoretical case for such use of mediators and presents preliminary evidence that transactional mediation already is taking place.

In the last twenty years, lawyers, judges, and litigants have become increasingly accustomed to using mediators to help settle legal disputes. The growing acceptance of mediation in the litigation context raises a puzzling question, however: Given that transactional negotiations are in some ways quite similar to dispute resolution, why has there been no corresponding rise of mediation in deal-making?

Transactional legal practice can be as adversarial as litigation. Deals break down. Communication falters. Relationships sour. Emotions rise. There often are strong advocates, whether lawyers or clients, on each side in major transactions. Those advocates frequently take positions and push for advantage. These are the same bargaining dynamics that can make a mediator valuable in settling disputes. Why then, don't mediators help contracting parties as they try to close deals, just as mediators help litigating parties reach settlement?

This article analyzes the use of mediators in dispute resolution and in deal-making. It briefly presents the benefits of transactional mediation and addresses whether it may be a growth area for the mediation community.¹ Some recent research suggests mediators already are serving in this capacity, although sporadically. The article discusses reasons transactional mediation has not been used more often and provides a rationale for when and why it may be used effectively.

Overview of Mediators And Dispute Resolution

To address how transactional mediators may be effective in deal-making, it is essential to first examine why mediators are used in the litigation context. The alternative dispute resolution ("ADR") community—both scholarly and practical—has said remarkably little about this matter. Practicing mediators often give a quick, simple, and somewhat vague response when asked what they do: "We help parties settle."

As a general matter, however, mediators play four important functions in dispute resolution. As discussed below, mediators can: (1) discover whether settlement is possible; (2) help the parties find value-creating trades; (3) manage psychological barriers to agreement; and (4) deal with emotional and relational problems.

Discover if Settlement Is Possible

A mediator can solicit and compare private information about the parties, their willingness to settle, their concerns, and their priorities. A mediator can, for example, confidentially compare a defendant's offer and a plaintiff's demand to determine if they overlap. A private comparison of this sort may encourage parties to take more reasonable positions than they would otherwise, because a confidential offer or demand sends no signal to the other side about a party's bottom line.

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Put differently, parties often exaggerate demands and minimize offers because they fear exploitation. Each is concerned that if he or she states a true bottom line, the other side will take advantage. If both parties think and act this way, their offers and demands may never overlap. By creating the possibility of private exchanges, mediators can help the parties discover whether settlement is possible, thereby avoiding deadlock.

Develop Value-Creating Trades

Mediators also can use their access to private information to help parties find value-creating trades. Much has been written about interest-based problem solving and the promise it offers to disputing parties.² Rather than merely fighting over what a court would do, parties instead can explore their underlying concerns and priorities to discover whether there are trades that could make one party better off at a low cost to the other.

By allocating assets and risks to the person who values or can absorb them most efficiently, negotiators theoretically "expand the pie." Unfortunately, this does not always happen. Instead, strategic posturing may limit the parties' abilities to find value-creating options or trades. By interviewing parties privately to discover interests and search for trades, a mediator may add value to the parties' negotiations.

Mitigate Psychological Barriers to Settlement

Mediators can add value by mitigating the effects of cognitive and social psychological biases and heuristics that can impede settlement. Much work recently has been done exploring such "behavioral" aspects of negotiation and mediation.³ In general, mediators can help parties manage several psychological effects.

Parties often are systematically overconfident in their judgments and beliefs. Mediators may be able to help them overcome such overconfidence. Similarly, mediators may be able to help parties avoid "reactively devaluing" each other's proposals merely because they come from an adversary.

Mediators also may be able to help parties overcome a phenomenon referred to as "loss aversion," which tends to make a person more willing to gamble to avoid a sure loss than the same person would risk to secure a gain. By framing possible solutions in ways that mitigate these psycho-

logical biases, mediators can help parties to behave more rationally.

Manage Emotional and Relational Issues

Mediators often manage emotional, relational, and communication problems among disputing parties. Mediators may empathize with upset parties or help the parties empathize with each other. They may be able to help the parties continue talking, despite a damaged relationship. Mediators also may slow down the communication process to add clarity to what otherwise may be a difficult negotiation.

In summary, mediators serve various roles. They can use their positions as neutrals to add value through information gathering and comparison. They also can use their third-party perspectives to help identify and manage psychological, emotional, and relational difficulties. These are some of the functions that have led to the increasing use of mediators in legal disputes.

Role of Mediators In Transactions

The legal community tends to assume that litigation is more adversarial than transactional work. Nonetheless, any transactional attorney can provide examples of deals that died prematurely or were concluded at great cost and aggravation because of adversarial posturing and tensions. This suggests that contract negotiations sometimes present some of the same barriers to successful resolution that are found in litigation settlement.

On closer inspection, this is indeed the case. In each domain, there are incentives for parties to behave strategically to get more for their side, psychological barriers that may get in the way of an agreement, and emotions that can run high and cause relations to sour.

Parties may take extreme positions on deal terms or contract language and, thus, find themselves in a deadlock. They may miss value-creating trades that could make one or both better off. They may be mired in psychological, emotional, and relationship problems. All of this suggests a role for transactional mediators.

Competitive Business Markets Discourage Mediation

Deals and disputes differ in important ways, and it is important not to overdo the case for transactional mediation. There is a powerful argument for why transaction-

al mediation is relatively unknown. Deals, the explanation runs, are concluded in competitive markets. If party A cannot negotiate satisfactorily with party B, then party A will move on and do the deal with party C. This ability to exit negotiations and turn to the market diminishes the ability of A, B, or C to be strategic, to posture, and to be adversarial.

In litigation, the parties are stuck with each other—party A either settles the case with B or goes to court. This is a "bilateral monopoly," where neither party can walk away. As such, it permits strategic or adversarial bargaining.

In transactional negotiations, by contrast, the competitive market should "discipline" adversarial posturing and make things more civil. Put differently, neither party in a transaction can price above marginal cost, because doing so would invite another more competitive party to enter the negotiation and underbid them.

Seen through this economic lens, deals and disputes look less similar. Instead, the following closely-related hypotheses emerge:

1. Transactions conducted in competitive markets should be less strategic and adversarial. Thus, mediators would not be involved in assisting in such transactions.
2. Transactions conducted in "bilateral monopoly"-type markets should be more strategic and adversarial, similar to disputes. It is more likely that mediators would assist in those transactions.

These hypotheses predict that mediation will arise in markets that have bargaining conditions favorable to third-party assistance.

Preliminary Evidence of Transactional Mediation

Although mediation is not well known in transactional work, there are some significant exceptions. One context in which mediators routinely assist parties in trying to form contracts is labor-management negotiations. Although such negotiations often are portrayed as "disputes," technically they are deals, albeit special ones. In labor relations, the parties are trying to create a contract. The presence of a union removes (or greatly weakens) management's ability to go to the market in search of alternative sources of labor and, thus, the negotiations are like the bilateral monopoly that is found in litigation. It is no surprise, therefore, that mediators are active in assisting such parties.

Similarly, certain markets present clear bilateral monopolies. One modern example is the sale of Internet domain names. Suppose Party A holds a domain name and Party B wishes to purchase it for use by Party B's new company. There is only one available seller and (most likely) only one interested buyer. In such circumstance, there is great incentive to hold out and bargain hard. Not surprisingly, domain name transfers have given rise to a fairly complex mediation and dispute resolution system to help buyers and sellers overcome these problems.⁴

Survey of Mediators

To find out whether mediators are involved in deal-making, the author conducted a national survey of more than 122 practicing mediators. It was a fairly informal survey in which participants indicated the types of mediations they had conducted over the last several years.

Although the survey is not perfect, and its results are not necessarily statistically significant or valid, it is a suggestive first start. The survey asked mediators about:

(1) the nature of their practice; (2) the types of disputes they typically handle; (3) their experience level; (4) whether they had ever mediated in a pre-closing transaction, with specific examples provided, including real estate, employment contract formation, and labor-management; and (5) if they had been involved in transactional negotiations, details of that experience.

The survey indicated that approximately 39 percent of the mediators had been involved in transactional mediation. Forty-eight of the 122 mediators surveyed indicated that they had mediated in at least one transaction. These transactions ranged in value from \$100,000 to \$26 million and included the following examples:

- Assisting with negotiations over the formation of a partnership of practicing physicians
- The sale of a motorcycle dealership
- The formation of pre-nuptial agreements and domestic partnerships
- Re-allocation of property rights and governance in a golfing community
- The establishment of a joint venture between a small business and a Fortune 500 company

- The sale of cable television access rights
- Formation of a cross-country ski league
- Creation of a houseboat community association
- Creation of a joint venture to produce software
- Negotiations over the terms of a real estate brokerage contract
- The transfer of control within a closely held software development firm
- The formation of a partnership to own an airplane (the parties needed to work out issues as varied as fees and the placement of stickers on the tail fin)
- The negotiation of "angel funding" for a privately held business
- Mergers between two or more corporations.

These examples from the survey seem to support the two hypotheses laid out above. Many, even most, of the examples either have or easily could have bilateral monopoly characteristics. For example, the transfer of control within a closely held software company could involve one sell-



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er and only one potential buyer. In such circumstances, as already explained, each party may have incentive to bargain hard and push for a greater share of the proverbial pie. Given those incentives, it is not surprising that mediators are beginning to step in to help.

As expected, the majority of mediators in the survey (61 percent) did not indicate involvement in transactional mediations. The idea of transactional mediation as a field is new, and there has been little discussion of it to date in mediation literature, trainings, and conferences. Moreover, as discussed above, in most markets, it makes little sense to involve a neutral in deal-making. Only when a market is highly imperfect—when bilateral monopoly conditions exist, for example—will strategic bargaining make sense and a mediator be able to add value.

Why Transactional Mediation Has Been Limited

Although transactional mediation makes sense in some contexts, most mediators have never heard of it. Why is this? First, the ADR movement has several deep roots, none of which connects to the transactional or deal-making world. The modern ADR movement grew out of the conflict resolution traditions of the Quakers and other religious groups, many of which were active in the 1800s and early 1900s.

Since the 1970s, ADR has developed as an alternative to litigation and a way to relieve stress on the court system. Judges, academics, and practitioners have seen mediation as a complement to the established judicial system. This history thus has connected the modern use of mediation directly to litigation, but not to transactional work.

In addition, the modern ADR movement, like any movement, has had its counter-cultural tendencies. One of those tendencies has been to justify itself as a better alternative than going to court. Although this approach helped to market mediation early on, it perhaps has resulted in a lack of development of positive justifications for and definitions of the practice. As noted earlier, there has been remarkably little discussion about exactly how mediators add value above and beyond what negotiating parties can do for themselves. A close examination of that question, however, leads naturally to the realization that mediation might be able to help negotiators—not just disputants.

Perhaps most important, understanding of negotiation and dispute resolution have made possible the sort of analysis summarized in this article. There are two trends worth highlighting. First, negotiation scholars are turning to various disciplines to advance the understanding of bargaining. This also is increasingly true in mediation scholarship. By using economics and psychology, similarities begin to emerge that previously were obscured.

Second, negotiation scholars are becoming more interested in deal-making and transactional bargaining generally. Indeed, legal scholarship on contracts, corporate law, mergers and acquisitions, and other deal-related areas has become more intertwined with negotiation scholarship. It may be only a matter of time before these same interests connect to scholarship on mediation.

Conclusion

It is worth reiterating that transactional mediation is very new. There are no books to read about it yet, and no seminars to attend on how to do it. Additionally, not many mediators are doing such work. Nevertheless, there are strong theoretical and practical reasons that transactional mediation makes good sense. Both mediators and transactional lawyers may wish to consider how ADR can impact transactional work through the use of mediators and other neutrals during transactional negotiations.

NOTES

1. This article is based on a longer forthcoming article by the author. See Peppet, "Contract Formation in Imperfect Markets: Should We Use Mediators in Deals?" to be published in *Ohio State J. on Dispute Resolution* (Feb. 2004).

2. For an in-depth discussion of value creation in the context of legal negotiations, see Mnookin, Peppet, and Tulumello, *Beyond Winning: Negotiating to Create Value in Deals and Disputes* (Cambridge, MA: Harvard Univ. Press, 2000). See also Fisher, Ury, and Patton, *Getting to YES*, 2d ed. (New York, NY: Penguin Books, 1991).

3. For a useful introduction to this field, see Arrow et al., *Barriers to Conflict Resolution* (Cambridge, MA: PON Books, 1999).

4. See Parchomovsky, "On Trademarks, Domain Names, and Internal Auctions," *Univ. Ill. L.Rev.* 211 (2001). ■

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