In recent years judges, journalists, parliamentarians and the public have made known their frustration with our often cumbersome legal system. The legal profession has at the same time been criticised over perceptions of self-interest. Some of these criticisms may be valid. However, writes Carol Dance, a quiet revolution in the Australian approach to law is taking some commercial disputes out of the courtroom and settling them in a new style of quick, cheap, round-table justice. ADR is putting a friendly face on the legal system.

The common law system of justice has been described as a Rolls-Royce system. The court process is formal and structured. By means of examination and cross-examination of witnesses, facts are elicited by sharp-witted legal representatives as part of the presentation of their client's case. The learned judge, having heard the facts, makes a decision based upon his or her understanding of the applicable law.

This is the strength of the entrenched court system. In disputes where there are complex questions of law, the courts provide answers.

Paradoxically, the courts are entirely the wrong place for the resolution of most commercial disputes, which may be based upon complex technical questions and issues of fact. An example is the Spedley Securities and ANI case, which came before the New South Wales Supreme Court in 1992.

The case, in which $900 million was in contention, was of immense factual and technical complexity. ANI had spent more than $35 million in legal fees and it was estimated that a further $50 million would have to be spent if the matter were to be pursued to judgment through the court system. This was despite the fact that ANI believed that there was little chance that the court would have found it in any way liable to Spedley.

Eventually, the parties agreed to mediation and Sir Laurence Street was appointed to try to resolve the dispute. The mediator worked with the parties, discussing matters both in group meetings and in private meetings where information could be taken in confidence. He did not impose a settlement. Spedley liquidators and ANI settled for an amount equivalent to the estimated costs of continuing litigation. Although ANI was certain it would eventually have won the case, it opted to minimise its risk.

This example is extreme but it illustrates two shortcomings of using the court system in commercial disputes:

- it is expensive and time-consuming;
- there is no guarantee that the solution imposed by the court will be either desirable or attainable.

Although many businesses attempt to resolve their disputes without going to court, large sections of the business community have failed to examine other options available to them once negotiations have broken down.

The solution

It is inevitable that certain commercial disputes will find their way to

Carol Dance is chief executive officer of the Australian Commercial Disputes Centre. She is a member of the Law Council's Alternative Disputes Committee, the Institute of Company Directors National Dispute Resolution Committee and the Advisory Board of Macquarie University's Conflict Resolution Centre.
court. However, as Justice Andrew Rogers stated last year in the NSW case between AWA and Deloittes: “It is unacceptable that with other methods of dispute resolution available, the courts should be the sole repositories of these corporate struggles.” In this case Justice Rogers estimated that costs were exceeding $500,000 a week in a hearing which was expected to take three months. After 12 days of hearing, he sent the matter out to mediation, despite the objections of the defendants.

Mediators can deal with the whole dispute or merely certain aspects of it. In the latter case, by concentrating on those issues where the parties are in fundamental disagreement, rather than the piecemeal dissection of every issue, the process can result in a huge saving of time and money. Other advantages of mediation are:

- the process is confidential, preserving the privacy of organisations and individuals;
- the parties can choose a mediator with appropriate legal or technical expertise;
- the parties elect whether to have legal representation;
- the settlement between the parties need not be based solely on monetary compensation. As settlement by mediation is based on agreement between the parties, the agreement they reach is a commercial one, not one imposed by a third party;
- the business relationship between the parties is preserved and may be enhanced.

Many members of the Australian judiciary have embraced the concept of mediation since it acquired legislative force in the Federal Court in 1992. The Family Court, too, uses mediators. In 1991 and 1992, many cases in the lists of the District and Supreme Courts of NSW were referred to mediation as part of Law Society Settlement Week. Mediation resulted in a high rate of settlement of the cases.

The NSW Supreme Court has plans to phase in a system of mandatory mediation over three years. Eventually, parties will have to show that they have genuinely attempted mediation before they will be allowed to bring their cases before the court. A program of court-annexed mediation is also being contemplated in Victoria.

Mediation is suitable for most commercial disputes. The process is flexible and varies according to the needs of the parties and the dynamics of their relationship. Part of its flexibility lies in its use in conjunction with litigation. The parties in dispute may be able to settle most issues by mediation, leaving the difficult legal conundrums to the judge. This drastically reduces the amount of time and money the parties spend in court.

Eventually parties will have to show that they have genuinely attempted mediation before they will be allowed to bring their cases before the NSW Supreme Court.

However, mediation is only one of a variety of non-court methods of resolving disputes. The collective name given to these processes is “alternative dispute resolution” (ADR). The processes have been used in the US for a number of years and were introduced into Australia in 1986 when the NSW Government established the Australian Commercial Disputes Centre (ACDC).

The other processes offered by ACDC are:

**Expert appraisal**: an independent third party examines documentation, discuss the dispute with the parties and advises on the most desirable resolution. The parties can use this appraisal as a basis for negotiation. This method is very commonly used in technical disputes.

**Expert determination**: the parties agree in advance to be bound by the decision of an independent expert who examines the documentation, confers with the parties and then makes a determination. This method, which is quick and relatively inexpensive, is very commonly used to resolve simple disputes and those which do not involve large amounts of money.

**Arbitration**: a more formal, expensive and adversarial process where the parties submit their dispute to an independent third party who makes a decision binding upon the parties. ACDC arbitrations are quite flexible, granting the parties a large amount of control over the arbitration process.

Often the parties provide for a two-tiered process. For example, in matters of technical complexity, settlement may be impeded by the fundamentally differing views of the parties on certain of those technical issues. The parties may agree to expert determination of these issues followed by mediation to settle the question of money. Sometimes the parties agree to attempt mediation and to go to arbitration if this fails.

**Australian success stories**

**Foreign currency borrowers disputes.** Some borrowers had insufficient money to go to court. The banks needed a resolution of the disputes as they were bringing bad publicity. The House of Representatives Standing Committee on Finance and Public Administration (November 1991) recommended that “an independent mediator, funded by the banks, but acceptable to both parties be appointed to mediate foreign currency loan cases”. As a result, several banks have settled disputes through mediation.

**A franchisor and franchisee** were in dispute over the interpretation of one of the terms of a five-year contract. Although only $8,000 was in contest, it was essential that this term be clarified so that the contract could be properly performed. The parties started litigation in the Supreme Court. One year and $200,000 later, the parties’ relationship had disintegrated. One of the solicitors calcu-
lated the costs of continuing litigation and suggested mediation. After a great deal of negotiation by ACDC, the parties agreed upon a mediator and the terms of the mediation. They reached settlement after one day of mediation a settlement which could not have been achieved by a court. The parties estimated that each had saved $300,000 and one year of time.

A builder and sub-contractor were in dispute over $20,000. Neither party wished to go to court but the dispute was damaging a long-standing business relationship. One party approached ACDC. The parties agreed to resolve their dispute by expert appraisal. The expert read the documents, met the parties and gave his opinion. In the same three-hour meeting, the parties reached settlement and restored their relationship.

A lessor and lessee were in a three-year dispute over one clause of a contract which involved $1 million. The parties approached ACDC, dealt with the question of interpretation of the contract by expert determination and agreed to mediation for the amount. The dispute was resolved within three months. The cost to the parties was $6,000 each.

American success story

The Bank of America case was spectacular because of the number of plaintiffs a class of 800,000 cheque-account holders.

The dispute arose because the bank had failed to advise on the cheque account application form, or elsewhere, that the customers would be charged overdraft fees. The settlement was creative and not based upon a payout. The settlement was as follows:

- the Bank of America had to change its application form;
- the bank had to change the way it cleared cheques so that smaller cheques were cleared first;
- credit card members received a year’s free subscription to their credit cards;
- all disputants received grace on overdrafts (to a maximum of three) for a year;
- the bank paid for a two-minute public television spot on how to use a cheque account responsibly;
- the bank had to give a total of $4 million in loans to disadvantaged business enterprises (up to $100,000 per enterprise)

The customers were happy with their free services and with the bank’s display of corporate citizenry. The bank was pleased to have happy customers and it did not have to pay out large penalties.

International disputes

ACDC is a signatory to the International Centre for Settlement of Investment Disputes; the US-Australia Trade Dispute Agreement and the Asia-Pacific Registry for the London Court of International Arbitration. A number of international disputes, including financial disputes, have been resolved by mediation.

FREE LUNCH FOR SUPER FUNDS Continued from page 5

of “good” risk obviously, the greater the positive semi-deviation, the better. In contrast, the potential for downside risk can be measured by “negative semi-deviation”. This measure analyses those observations when returns are lower than the mean. Our aim is to minimise this type of risk, all else being equal.

The previous simulations were repeated to compare the impact on risk of various hedging strategies. Almost without exception, superannuation funds prefer hedging strategies which retain the potential to benefit from currency gains when the domestic currency is depreciating. This effectively eliminates the possibility of hedging the full exposure with forwards.

Therefore this analysis examines three strategies which retain upside potential. It should be remembered from the former results that all three strategies will have the same long-run returns.

The high degree of risk under the unhedged strategy is apparent no matter what measure of risk is used. By hedging one-third of the portfolio with forward cover, this risk is naturally enough reduced by about one-third. However, the forward cover strategy reduces the upside potential as much as it reduces the downside risk.

The real benefit of the option strategy lies in the ability to reduce downside while retaining upside. Notice that strategies (b) and (c) have the same amount of downside risk as measured by negative semi-deviation. When we consider the extreme case of the minimum currency return, we can see that the option is actually more effective in limiting the potential for extreme currency losses.

However the “good” risk or positive semi-deviation is far greater under the option strategy than is possible under forward cover. Again, this can be seen in the extreme case of the maximum possible return achievable. Note that when significant depreciation of the $A occurs, currency gains under the option strategy are almost as great as those under the unhedged strategy.

This “skewness” is very attractive to investors. Studies have shown that rational investors are even prepared to sacrifice expected returns in order to achieve skewed distributions. In particular, “skewness” in returns is extremely attractive to superannuation funds. This is partly due to the fact that “upside” risk is useful as a diversifying factor in a balanced portfolio. For example, there may be occasions when a fall in stockmarket values coincides with favourable currency movements. In this case, favourable currency returns offset losses wherever in the portfolio, thus helping fund diversification.

Skewness can also be helpful as a hedge against superannuation fund liabilities. For example, retirees are exposed to the risk of a significant fall in the $A which will tend to increase inflation in the local economy. Unhedged offshore assets form a natural hedge to this risk. That is, if the $A falls, currency gains on offshore assets will offset the increased cost of living. As has been shown, the option approach to hedging retains the potential for currency gains and therefore the natural liability hedge.