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Avoiding Court: Alternative Means to Settle Contract Disputes

For as long as companies have been providing goods and services to their customers, they have collaborated with other companies to provide the inputs or processes they cannot create or perform on their own. The most common way of formalizing these relationships is through the use of a contract. Contracts are legally-binding documents or agreements that define the nature, duration, and extent of the working relationship between the two firms. Contracts can be as simple as a verbal agreement or a one-page memorandum for record, or they can consist of scores of pages of text outlining even the most minute detail.

In the modern business environment, the survival or failure of many businesses is at least partially a result of its contract portfolio and the decisions it makes to contract with other firms. Unfortunately, even the best conceived and developed contracts are at risk for breaches and disagreements, especially when the dollar amounts are particularly large.[1] Since contracts are legal documents, the formal way to settle a contract dispute is through litigation in a court of law. While that is certainly an option firms may use, going to court is typically the last resort to resolving whatever the disagreement may be.[2] Lengthy, expensive, and unpredictable proceedings in court are not attractive to firms who would rather get resolution faster and in a more discreet

[1] Robert M. Monczka, Robert B. Handfield, Larry C. Giunipero, and James L. Patterson, *Purchasing and Supply Chain Management, Sixth Edition*. 20 Channel Center Street, Boston, MA 02210: Cengage Learning 2015, 560.
[2] Monczka et al, 561.

manner.[3] Before addressing how to settle disputes once they occur, this paper will examine some common methods firms us to prevent these disputes from occurring.

The best time to avoid a contract dispute is at the beginning of its lifecycle: during the negotiations that lead to its establishment. When firms enter into agreements, they are obviously excited and optimistic about the possibilities associated with that venture. They would not be making a binding commitment to each other if they did not believe this. As a result, it can be difficult for firms to have frank discussions about procedures for addressing and penalties associated with noncompliance or breaches of the agreement. In order to get the program going, some firms fail to account for the possible issues that may arise. This can have costly consequences down the road when the "honeymoon" period ends and problems arise.[4]

The primary approach to avoid a dispute is to establish specific controls and criteria to address the timeliness, quality, and price of the goods and services to be provided. Words in a contract are meaningful, so taking the time to ensure that each word conveys, unequivocally, the intent of the agreement is critical. Goals or provisions should be in accordance with the SMART principle – specific, measurable, achievable, relevant, and time-based. For example, if the contract states that the steel for a construction project will be delivered "as soon as possible," this violates the specific and time-based principles. "As soon as possible" might mean next week to you, but the

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[3] "The Benefits of Arbitration as a Method of Dispute Resolution," *Pearse Trust Blog*, Published 30 January 2012, <https://www.pearse-trust.ie/blog/bid/81199/The-Benefits-Of-Arbitration-As-A-Method-Of-Dispute-Resolution>.

[4] Rain Minns Law Firm, "A Few Simple Tips for Avoiding Contract Disputes," HG.org Legal Resources, <https://www.hg.org/article.asp?id=21995>.

supplier may read that as six months from now. This provision would be a strong candidate for a future disagreement. Some provisions are not quite so obviously flawed. Expected quality levels and acceptable defects are also very important to establish before beginning work on a contract. It is not reasonable to expect perfect compliance and perfect quality 100% of the time, so the contract must clearly define the standard of performance and the penalty or cost associated with noncompliance.[5]

A second, and more innovative, method of avoiding contract disputes is through a formal process known as dispute prevention. Dispute prevention is a means of formalizing a "progressive schedule of negotiation, mediation, and arbitration, following by litigation as a last resort."[6] More specifically, dispute prevention codifies a measured approached to keeping the contract in compliance. It outlines the steps clearly to show both parties the cost of noncompliance or breaches. Since the process for dealing with disputes is clearly delineated, it provides managers at the tactical level incentive and a roadmap to avoid letting problems go unchecked. If production managers and category managers can identify issues early in accordance with pre-determined evaluation timelines, they can take proactive measures to address them before they rise to the level that third-party arbitrators or corporate managers need to get involved. These dispute prevention techniques remove ambiguity and encourage resolution at the lowest level.

The common theme between both of these alternatives to prevent contract disputes is planning. The only way to keep the firm in compliance or out of court is to

[5] Rain Minns Law Firm.
[6] Monczka et al, 564.

provide as much detail in the contract as possible and take the necessary time to iron out the friction points before they arise.[7] Hand-shake, simple agreements may have been sufficient in previous generations, but modern firms simply cannot accept the risk associated with leaving the details to chance. Getting ahead of problems and applying lessons learned from previous contract experiences can help guide firms in generating smart, enforceable contracts.

Despite a firm's best efforts to prevent disputes, there are times when a breach occurs that cannot be avoided. While settling a dispute in court is always an option, firms usually try to take whatever steps they can to avoid the cost and hassle of a lawsuit. There are alternatives to court that are generally much preferred: arbitration, mediation, minitrials, or "rent-a-judge."[8] These avenues to avoid litigation are called "alternative dispute resolution" or ADR. While these methods are similar in that they avoid the courtroom, they are quite different and are selected to achieve different ends.

The ADR method that is the most similar to court proceedings is arbitration. In arbitration, a third-party individual or panel hears arguments and analyzes evidence to produce a binding decision that solves the dispute.[9] It is important to note that arbitration is adversarial in nature because bringing in a third-party means the two firms were unable to put their differences aside and come to a negotiated agreement on their own. Arbitration can be an appealing alternative to court proceedings for many

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[7] James P. Groton, Robert A. Rubin, "Brief Review of the Typical Dispute Prevention and Resolution Best Practices," *The National Academies Press,* Published 2007, <https://www.nap.edu/read/11846/chapter/4>.
[8] Monczka et al, 561.
[9] John R. Allison, "Five Ways to Keep Disputes Out of Court," *Harvard Business Review*, Jan-Feb 1990 Issue, <https://hbr.org/1990/01/five-ways-to-keep-disputes-out-of-court>.

reasons. Foremost, arbitration maintains the privacy or confidentiality of the ruling. Court proceedings are obviously public, so if the firm wants to prevent any sort of negative press or to protect intellectual property, arbitration can serve those purposes.[10] Arbitration is also much faster and cheaper than a lawsuit. The parties do not have to wait for space on a circuit court judge's docket to get resolution since the arbitration process and location would be expressly identified in the contract. Typically, an arbitrator's decision is a compromise that is agreeable to both parties, so that is usually preferred to the "all-or-nothing" nature of court litigation.[11]

Another alternative to litigation to settle a contract dispute is through mediation. Mediation also involves the use of an impartial third-party to solve a dispute, but the mediator does not render a binding decision or provide a solution. Mediation is a formalized means to assist the two firms in coming to their own resolution of the dispute. If an arbitrator plays the role of judge and jury, then the mediator plays the role of counselor and mentor to guide the parties to an agreeable outcome.[12] While a mediator can facilitate discussion and even recommend or advocate for a solution, the two parties retain the final say in whether to accept the resolution or not.[13] Like arbitration, mediation is also a confidential process that is much cheaper and less time-consuming than taking litigation to court. Mediators may have formal legal backgrounds, or they may simply be experts in the industry in question. No matter the mediator's expertise, he or she is enlisted to provide guidance on agendas, points of agreement, and possible

[10] "The Benefits of Arbitration as a Method of Dispute Resolution," *Pearse Trust Blog*, Published 30 January 2012, <https://www.pearse-trust.ie/blog/bid/81199/The-Benefits-Of-Arbitration-As-A-Method-Of-Dispute-Resolution>.
[11] Monczka et al, 562.
[12] John R. Allison.
[13] Monczka et al, 562.

compromises. In many ways, the mediator can become the "cool head" in the room that drives the competing firms toward an amenable conclusion.

Another, less common, means of alternative dispute resolution is through the use of a "rent-a-judge." Through this process, the two firms select a retired judge to serve as the arbitrator for the disagreement. It differs from other forms of arbitration in that it follows trial procedures more closely, and the outcome carries the same weight as a court-rendered judgment.[14] Because the rent-a-judge proceeding adheres to trial procedures, arguments and evidence presentations must follow the rule of law more closely than other forms of arbitration. Additionally, since the ruling is conducted with legal effect, if one or both of the parties disagrees with the judge's opinion, the firm may appeal the decision according to the laws in place for that jurisdiction.[15] Renting-a-judge also speeds up the process of getting resolution for the disagreement and reduces the cost and negative exposure a firm may face in open court.

Contracts are a necessary component of all business transactions and relationships. They are the way that agreements are formalized and executed by members of each firm involved. All relationships face challenges, so it is important to anticipate those challenges before they arise. By taking ample time to draft contracts that clearly articulate terms and conditions, firms can protect themselves from ambiguity and misunderstanding. Thorough controls and dispute prevention measures can reduce a firm's risk of facing a contract dispute with a business partner. If the problem becomes untenable, firms can turn to arbitration, mediation, or rent-a-judge proceedings

[14] John R. Allison.
[15] Monczka et al, 563-564.

to resolve the conflict. These forms of alternative dispute resolution all aim to keep the two firms out of court and avoid the time, money, and public notoriety that come with formal litigation. The goal of the contract dispute is to correct the action or behavior that is not in keeping with the contract's provisions and, usually, return to a normal, healthy business relationship. When the contract fails, neither firm wins. Firms strive to resolve conflict early and at the lowest level possible to keep margins high and the company in a position to maintain competitive advantage.

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