The Business Case for SMART™ Dispute Resolution Processes

By Richard L. Hurford

Introduction

This edition of the *Michigan Bar Journal* focuses on alternative dispute resolution, and it may help to provide a slightly modified nomenclature and paradigm for consideration: SMART™ dispute resolution. SMART™ dispute resolution systems are **s**trategic, **m**easurable, and **a**ppropriate, generate a significantly enhanced **r**eturn on investment, and are **t**eachable. While litigating a case through trial may be smart for the resolution of some business conflicts, it is clearly not the case for each and every dispute that businesses confront in managing their portfolios of risk. SMART™ dispute resolution mechanisms enable businesses and their counselors to reduce costs, decrease the risk profile of the enterprise, increase loyalty among key stakeholders, and cultivate greater business possibilities.

From the perspective of a former in-house counsel for a Fortune 200 company, it is critically important for legal services providers to be smart by fully aligning themselves with the short- and long-term dispute resolution needs of their clients. Businesses relying solely on the litigation process and counselors who don't explore all appropriate alternatives with their clients fail to realize significant, readily available cost savings and risk-mitigation opportunities.

Attributes of SMART™ Dispute Systems

Dispute resolution mechanisms are *strategic* when they are designed to achieve specific, identifiable objectives of the business; *measurable* when data is captured and metrics established to determine if the business's strategic objectives are being met;[1] *appropriate* when they draw upon all the dispute resolution techniques available (recognizing that such techniques will undoubtedly continue to evolve), are "right sized," and meet the legitimate needs and expectations of the business stakeholders; smart when they result in significant cost savings and an enhanced *return on investment;* and *teachable* when their fundamental goals are learned and embraced by all stakeholders who focus on continuously improving the dispute resolution process to meet the strategic objectives of their organizations. The basic question that must be addressed is whether the litigation process is the sole dispute resolution process that is SMART™ in addressing the varied and nuanced risk profile of the enterprise. If not, alternatives should be robustly explored and exploited through the development of appropriate contractual language and practices.

Fast Facts:

It is critically important for legal services providers to be "smart" by fully aligning themselves with the short- and long-term dispute resolution needs of their clients.

Business does not view traditional litigation as a "profit center" and litigators should provide legal services accordingly.

The practice of hiring business litigators on a purely "time and materials" basis has (or should have) long since passed; this is not a strategy to ensure true alignment between the legal services provider and the client.

The Traditional Litigation Model and Client Dissatisfaction

Candor requires attorneys to acknowledge any number of truisms when addressing the dispute resolution needs and interests of their business clients. Indeed, most clients have become all too aware of certain "truths" about traditional litigation:

- Litigation is not a "profit center." Businesses that successfully reduce their risk profile and the cost of processing their portfolios of risk will enjoy a significant competitive advantage. As business counselors, attorneys must be committed to exploring ethical and legally enforceable methodologies for enhancing the competitive advantage of their clients.
- Unlike fine wine, litigation does not become better with time. There is a direct correlation between the length and cost of litigation, and as discovery and trial preparation continue, the costs of litigation increase *exponentially.* If a matter can be reasonably resolved to meet the agreed-upon strategic objectives of the client before these costs are incurred, it is incumbent on the counselor to discuss these opportunities with the business client and then creatively leverage these opportunities as early in the litigation process as possible. It is not a credible strategy to blithely barrel down the litigation highway without looking for appropriate exit ramps that serve the best interests of the informed client.
- Predicting the outcome of litigation requires evaluating the reaction of a judge and jury to the merits of a client's case and predicting the effectiveness of witnesses at the time of trial. As the saying goes, "Never bet on anything that can talk." Rare is the case that permits the litigator to guarantee a successful outcome. The legitimate and reasonably foreseeable risks presented by all litigation should always be on the litigator's checklist of issues to discuss as early in the dispute resolution process as practicable.
- Historically, less than 1.5 percent of all cases filed in state and federal courts ever result in a trial by a judge or jury, and only half of the those litigants "win." Even clients who win may ask if the time and expense (including the time and costs associated with an appeal) resulted in the requisite cost-benefit ratio and the organization's strategic objectives. It is no accident that business clients increasingly insist on a realistic litigation budget and risk analysis at the outset of the case. It is just good business sense to undertake a cost-benefit analysis well in advance of the first day of trial. The practice of hiring business litigators on a purely "time and materials" basis has (or should have) long since passed; this is not a strategy to ensure true alignment between the legal services provider and the client.
- The vast majority of business litigation involves three critical stakeholders: customers, suppliers, and employees. Litigation is not particularly well-suited to preserving or enhancing the relationship of a business with these stakeholders. If, as the literature suggests, it requires the expenditure of 5 to 10 times the cost and effort to replace rather than retain a customer,[2] one might ask if businesses are better served to develop a dispute resolution process that maximizes the potential to retain and enhance the very important business relationship with a customer.
- Although businesses crave predictability and control, the litigation process typically defies predictability and deprives the client of control. Recognizing this fact, attorneys would be well-served to explore SMART™ dispute resolution mechanisms that might enhance the client's control over the dispute and the predictability of outcomes.

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Literature is replete with examples and analyses documenting the costs of litigation to businesses in the United States and the fact that those costs are much greater than in other countries. Even a cursory review of the literature and supporting studies underscores the very real issues that require the collective attention of lawyers and their business clients:

- In the past 50 years, direct tort costs in the United States have risen more than a hundredfold while population has not doubled and economic output has risen only thirty-sevenfold.[3]
- A majority of senior attorneys (63 percent) report that the litigation environment in a state is likely to affect important business decisions.[4]
- Small businesses bear 69 percent of business tort liability costs but take in only 19 percent of business revenues.[5]

- Tort costs have reportedly increased in relation to the U.S. gross domestic product threefold since 1950 (0.62 percent to 1.87 percent).[6]

These disturbing trends are equally true for commercial contract disputes and employment liability.[7] This data should be a source of concern, particularly given Michigan's current economic plight and the flight of business from the state. The litigation costs of doing business in the United States are unquestionably a significant impediment to attracting and retaining business and business investment. This fact is well-documented and evaluated in a study commissioned by the U.S. Department of Commerce entitled "The U.S. Litigation Environment and Foreign Direct Investment; Supporting U.S. Competitiveness by Reducing Legal Costs and Uncertainty."[8] Investment in the United States is decreasing, and among the factors contributing to this decrease are the cost and uncertainty of the U.S. legal system. Should Michigan develop a reputation for being a SMART™ dispute resolution zone, this could be a driver for economic development.[9]

In an attempt to cope with the realities of the litigation process, businesses and law firms have devised any number of creative measures to render the litigation process "less painful." Flat fees, reverse auctions, requests for proposals, process management techniques (e.g., Six Sigma, Lean, and other process improvement tools), the outsourcing of discovery and routine research, early budgeting, and a host of other strategies have been explored. In spite of the multiplicity of these initiatives, the Association of Corporate Counsel (ACC) has appropriately placed significant emphasis on its "Value Challenge" initiative. The project chair of the ACC Value Challenge has succinctly stated the reasons for this initiative:

> Even before the economic meltdown, corporate counsel had started pushing back more on rising legal costs and voicing their frustrations. "Costs keep rising, but with no noticeable improvement in efficiencies and outcomes…." The system is broken…. Better alignment is needed between costs and value.[10]

Like businesses, the ACC understandably wants and deserves "value," an increased return on legal investment, and a greater alignment of the interests between the business client and the legal services provider. Simply stated, at the very least there exists a perception that too many legal services providers are neither aligned with nor meeting the legitimate dispute resolution needs and expectations of their business clients. It is no accident that client loyalty is on the wane. If for no other reason than self-preservation, attorneys must be attuned to the short- and long-term SMART™ dispute resolution needs of their clients.

Potential Alternatives

As any seasoned litigator and sophisticated client knows, some disputes clearly require a trial. There will always be a critical role for a judge and jury in our system of jurisprudence. However, there are alternatives that may better serve the dispute resolution needs of business clients and lead to an enhanced return on investment and a greater alignment between businesses, their attorneys, and key business stakeholders.

Companies that were characterized by the AAA as "dispute wise" had stronger relationships with customers, suppliers, employees, and business partners and experienced significantly lower legal costs.

For example, it is estimated that 25 percent of the nonunionized workforce in the United States is subject to some form of mandatory pre-dispute agreements that waive the right to trial by jury and require the resolution of work-related disputes in a forum other than the state or federal courts.[11] Notwithstanding the current congressional attack on such agreements in the pending Arbitration Fairness Act,[12] these mechanisms, if appropriately designed, have been demonstrated to be a faster, less expensive, and fair method of resolving employment disputes.[13] Indeed, when adopted by a number of employers that require a two-step process (facilitation and then arbitration) for the resolution of all employment-related disputes, such agreements have resulted in transactional savings in excess of 30 percent for most of the businesses involved and an overall reduction in the amount of time to resolve the disputes by 50 percent or more.[14] Certainly, personal experience underscores these benefits and more. The additional competitive advantages to SMART™ dispute resolution mechanisms in the employment setting include enhancing the effectiveness of the human resource function, identifying and remedying troublesome practices as soon as possible, and promptly differentiating between bogus and potentially valid claims.

In an entirely different context, the University of Michigan Health System has developed a dispute resolution process in medical malpractice that provides a significant return on investment and the continuous improvement in its health-care delivery processes.[15] The specific business objectives for the development of this system were to compensate a patient quickly and fairly when unreasonable medical care causes injury, defend medically reasonable care vigorously, and reduce patient injuries (and therefore claims) by learning from the patients' experiences. The statistics that were captured document that the strategic objectives are being achieved. In addition to an impressive array of improved business processes, the Health System has realized a number of other measurable benefits. In August 2001, the University's Health System had 262 open claims; by the end of 2007, the number of

open claims had been reduced to 83. Over the same time span, the average claims-processing time dropped from 20.3 months to approximately 8 months. Total insurance reserves dropped by more than two-thirds. Average litigation costs per case have been reduced by more than 50 percent.

The wisdom of the dispute resolution systems cited are entirely consistent with a study published by the American Arbitration Association (AAA) in 2006 entitled "Dispute-Wise Business Management."[16] The AAA interviewed personnel in over 250 legal departments that included Fortune 1000 companies with mean revenues of more than $9 billion, mid-sized companies with mean revenues of almost $400 million, and privately held companies with mean revenues of approximately $700 million. Companies that were characterized by the AAA as "dispute wise" had stronger relationships with customers, suppliers, employees, and business partners and experienced significantly lower legal costs. Perhaps most significantly, those companies that the AAA identified as dispute wise averaged a 28 percent higher price/earnings ratio than the mean of all the publicly held companies surveyed. Dispute-wise companies also enjoyed a 68 percent higher price/earnings ratio when compared to their "least dispute-wise" counterparts. The AAA described dispute-wise organizations as:

> [embracing a] "portfolio approach" to disputes. Such an approach recognizes that "winning" should be measured by how well the organization manages over time the overall total economic and non-economic impact of the full array—or portfolio—of disputes it faces across all facets of its business.... Typical of the portfolio approach is a willingness to take a more global view of the full spectrum of an organization's disputes—addressing each of them in relation to other disputes in the portfolio with an overall goal of minimizing risk, cost, time spent, and resources expended, while preserving important business relationships.[17]

An approach that requires business counselors to explore and tailor any number of dispute resolution options in serving the strategic needs of their clients is smart. When dealing with suppliers, for example, what are the dispute resolution mechanisms that should be drafted into the contract that will enhance quality control, the early identification of potential issues, and the cost-effective resolution of disputes before the filing of a lawsuit? Clearly, at the time of entering into supply agreements there is far greater flexibility and likelihood of agreeing to a credible, fair, and efficient dispute resolution system than after a dispute arises. Which SMART™ dispute resolution mechanisms might businesses incorporate into contracts or adopt by practice when dealing with customers that maximize the opportunity to identify issues early on (e.g., enhances failure mode analyses, the potential pitfalls in existing product warnings and instructions, etc.), lead to continuous improvement, lower the cost of claims, and truly respect and be sensitive to the "voice of the customer"? While there may be valid business reasons for the absence of a SMART™ dispute resolution mechanism in contracts with employees, vendors, suppliers, independent contractors, and joint ventures, it is difficult to imagine a scenario when litigation will be the sole and best dispute resolution mechanism. With all of these critical stakeholders—regardless of the business setting—alternative strategies should at least be considered and evaluated. It is difficult to appreciate the business rationale for failing, without any discussion, to affirmatively incorporate SMART™ dispute resolution processes in most business agreements and relationships.

Conclusion

Litigation as a dispute resolution mechanism is here to stay; litigation can and does serve any number of legitimate and important business needs. For example, if a former employee or competing business is stealing a client's trade secrets or confidential and proprietary information, litigation may well be the most effective dispute resolution mechanism. There exists a significant benefit in clearly communicating to competing businesses and current employees that a business will vigorously protect its intellectual capital and trade secrets. Litigation involving certain "bet the company" issues may also be best addressed through very aggressive litigation. However, this does not suggest that SMART™

dispute resolution mechanisms cannot or should not be explored and brought to bear to serve the legitimate interests of businesses achieving what the ACC Value Challenge demands: a greater alignment between attorneys and clients. ■

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The author acknowledges the invaluable contribution of Zena Zumeta, a principal in the Mediation Training & Consultation Institute, to the development of the paradigm described in this article. Ms. Zumeta and the author have developed a program for businesses entitled "SMART™ Conflict Management and Dispute Resolution Processes."

FOOTNOTES

1. If the business adage "you become what you measure" is true, businesses and their advisors would be well-served to measure whether the objectives of any dispute resolution process are being achieved.
2. See, e.g., Jaffe, *Flip the Funnel: How to Use Existing Customers to Gain New Ones* (New Jersey: John Wiley & Sons, Inc, 2010); Roberts-Phelps, *Companies Don't Succeed—People Do* (Thorogood, 2008).
3. Pacific Research Institute, *U.S. Tort Liability Index: 2008 Report* (2008), p 9, available at <http://www.pacificresearch.org/docLib/20080222_2008_US_Tort_Liability_Index.pdf>. All websites cited in this article were accessed April 25, 2010.
4. Harris Interactive, *2008 U.S. Chamber of Commerce State Liability Systems Ranking Survey* (March 19, 2008).
5. Institute for Legal Reform, *Tort Liability Costs for Small Business* (May 17, 2007).
6. Tillinghast Insurance Consulting, *2007 Update on U.S. Tort Cost Trends*, p 5 (Connecticut: Towers Perrin, 2007).
7. O'Rourke, *Trends in Litigation, Risk Magazine* (January 2010).
8. The entire report can be accessed at the U.S. Department of Commerce website at <http://www.commerce.gov/s/groups/public/@doc/@os/@opa/documents/content/prod01_007457.pdf>.
9. Richard (Tony) Braun has written a companion article in this issue of the *Bar Journal*, indicating how an initiative spearheaded by The Engineering Society of Detroit, the Green Enterprise Zone, is evaluating alternative dispute mechanisms as one potential driver for economic development within Michigan.
10. Practitioners are advised to fully familiarize themselves with the "Value Challenge." Additional information concerning this initiative can be obtained at <http://acc.com/valuechallenge>.
11. See Hill, *Due Process at Low Cost*, 18 Ohio St J on Disp Resol 777 (2003).
12. S 931/HR 1020 would amend the Federal Arbitration Act and overturn the Supreme Court's decision in *Circuit City Stores, Inc v Adams*, 532 US 105; 121 S Ct 1302; 149 L Ed 2d 234 (2001) and prohibit all forms of pre-dispute arbitration agreements and promulgated plans in employment, consumer, franchise, or civil rights disputes.
13. Northwestern University, *Searle Civil Justice Institute Study* (March 2009) executive summary at <http://www.searlearbitration.org/report/exec_summary.php>.
14. See Insurance Times, vol XXIII (April 29, 2003); The Metropolitan Corporate Counsel, *The Same Results as in Court, More Efficiently: Comparing Arbitration and Court Outcomes* (July 1, 2006); SHRM Legal Report, *Achieving Workplace Justice Through Binding Arbitration* (1994); Hill, *Due Process at Low Cost*, 18 Ohio St J on Disp Resol 777 (2003).
15. *University of Michigan: A Better Approach to Claims*, 2 J Health & Life Sci L 125 (2009).
16. The full report issued by the American Arbitration Association can be viewed at <http://www.adr.org/sp.asp?id=29431>.
17. *Id.*