STAYING OUT OF COURT

Using alternative dispute resolution can save your company money and time.

By James W. Durham and Robert P. Wax

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Litigation is expensive and burdensome. In the electric utility industry, where competitors and suppliers work with each other on a daily basis to serve the public, going the litigation route is particularly problematic. Indeed, settling disputes between the utility and others in a timely and cost-effective manner is an important business goal. This is true for other sectors, as well, such as the construction industry (which deals with set schedules and a complex array of contractors and subcontractors) and technology companies (which have several suppliers and are competing with other companies in a fast-changing area).

All these industries use alternative techniques to resolve disputes in lieu of formal court litigation. Utilities—diverse businesses that deal with many different suppliers, manage large infrastructure projects, and have a large workforce—in particular have led the way.

In this multi-billion dollar industry, alternative dispute resolution (ADR) has largely involved mediation and arbitration of commercial and labor matters. With the coming of new transmission organizations, the use of ADR in the utility arena has grown significantly. While the specific processes and time periods for ADR vary, nearly all transmission organizations require some form of "good faith" negotiation or informal resolution process between disputants and, failing that, formal ADR, such as mediation and arbitration. And nearly all require some form of mediation and binding arbitration in place of court or regulatory litigation.

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Maybe even more important, in a new era of infrastructure expansion, siting, new baseload plants, and new energy markets, ADR use will continue to expand, as disputes inevitably develop in these complex arenas.

Utility companies enter into thousands of contracts each year with suppliers and others. Too often, those contracts don't include dispute resolution clauses. Perhaps the best explanation for that lack is that it's like discussing the possibility of divorce as you're getting married. The clauses require negotiation along with the rest of the contract and tailoring to the specific type of contract. It makes no business sense to ignore the value these provisions represent. Indeed, many agreements between companies cry out for standard ADR provisions—traditional mutual assistance arrangements are a good example.

Putting dispute resolution provisions in your contracts is good preventive maintenance. The practice of ADR in general gives your company speedy decisions, better business relationships, and comforting certainty in a complex industry.

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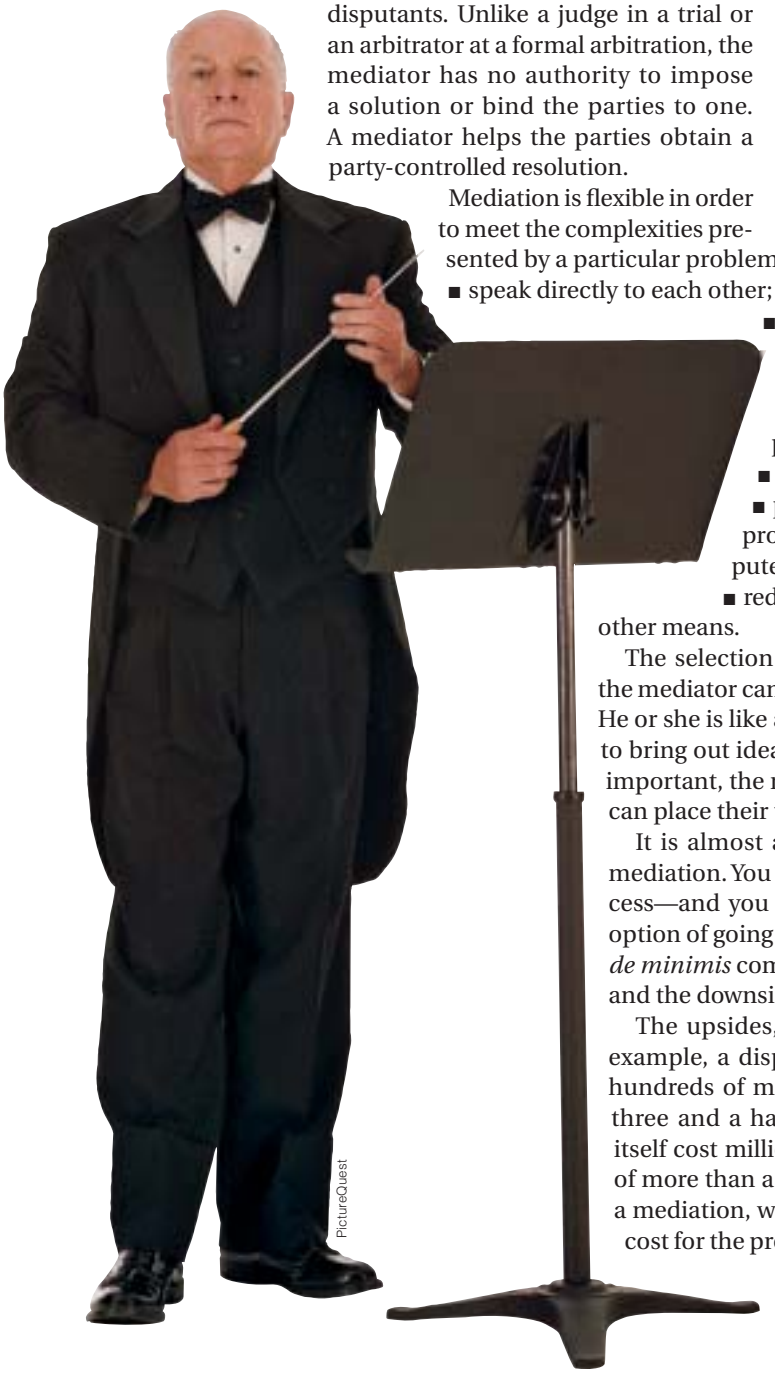
Trying Mediation

While many tools are available today to help parties resolve disputes without resorting to full-scale litigation, the two methods utilities most frequently use are mediation and arbitration. They are also the most frequently misunderstood—as a consequence, managements sometimes dismiss them in spite of their benefits.

Mediation is a nonbinding dispute resolution process that uses a neutral third party—the mediator—to facilitate the negotiation and resolution between disputants. Unlike a judge in a trial or an arbitrator at a formal arbitration, the mediator has no authority to impose a solution or bind the parties to one. A mediator helps the parties obtain a party-controlled resolution.



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Mediation is flexible in order to meet the complexities presented by a particular problem. The mediator helps the parties

- speak directly to each other;
- exercise complete control over the resolution;
- achieve remedies that may be outside the scope of the judicial or arbitration processes;
- maintain privacy and avoid publicity;
- preserve or reduce damage to otherwise profitable relationships in resolving the dispute; and
- reduce the costs and delay of a resolution by other means.

The selection of a mediator is a key decision because the mediator can greatly affect the outcome of the process. He or she is like an orchestra conductor, using many skills to bring out ideas and themes from others; perhaps most important, the mediator is someone in whom the parties can place their trust to guide the process.

It is almost always in everyone's best interest to try mediation. You can completely control its scope and process—and you can always walk away and still have the option of going to arbitration or litigation. The expense is *de minimis* compared to the amounts usually in dispute, and the downsides are few.

The upsides, on the other hand, are great. Take, for example, a dispute between two utilities that involved hundreds of millions of dollars several years ago. After three and a half years of litigation preparation, which itself cost millions of dollars and involved the exchange of more than a million documents, the parties agreed to a mediation, which resolved the matter in two days. The cost for the process was less than the postage bill for the previous three and a half years.

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Finding Speed and Finality

In arbitration, one or more arbitrators consider the issues in dispute and come to a decision. Arbitration is much like a court trial, with attorneys presenting the cases, but it is generally less formal. In most instances, the important factor favoring arbitration over litigation is the fact that the parties get to choose their decision maker. Not only can you affect the selection of the decision maker, but you also can shape the arbitration process: what discovery will be permitted, how the hearing will proceed, where it will take place, the relief that will be available, and, perhaps most important, when the matter will be heard.

Weigh the perceived lack of recourse against your chances in court litigation, as well. When you chose an arbitrator, you can select someone who understands the complexities of the industry.

Another advantage of arbitration is that it is not a public process, so you have confidentiality. Arbitration is also generally faster than litigation. Well-managed arbitrations by experienced arbitrators will always be less costly and more expeditious than formal court litigation.

Arbitration also offers finality. This can be a positive or a negative. There are limited grounds for overturning an arbitration award on appeal, so some may worry about that lack of recourse. Both parties, however, will be looking for an experienced arbitrator with a reputation for integrity, making the chances of an irrational result small. The chances are even smaller with a three-member arbitration panel, which most likely will come to an even more "deliberative" decision.

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Weigh the perceived lack of recourse against your chances in court litigation, as well. When you chose an arbitrator, you can select someone who understands the complexities of the industry. In a formal court, the jurist may not have such knowledge—not only do you run the risk of getting a decision that doesn't consider all factors, but also you must spend time during the trial in explaining difficult issues. In general, it is important in picking neutrals to make sure they understand the industry's unique issues and have expertise akin to the industry executives, lawyers, and experts appearing before them. (See the sidebar, "Finding the Expertise.")

A Cornell/PERC Institute survey of *Fortune* 1000 corporations shows that efficiency, economy, expertise, privacy, finality, and more satisfying and durable outcomes are all perceived benefits of arbitration. (PERC is the acronym for the Foundation for the Prevention and Early Resolution of Conflict.) Fulfillment of those expectations depends largely on the ability of the parties to tailor arbitration procedures to their

particular needs and goals. As the survey suggests, those needs and goals vary by company, transaction, and dispute. Ultimately, many businesses regard control over the process—that is, the flexibility to make arbitration what you want it to be—as the single most important advantage of this ADR method.

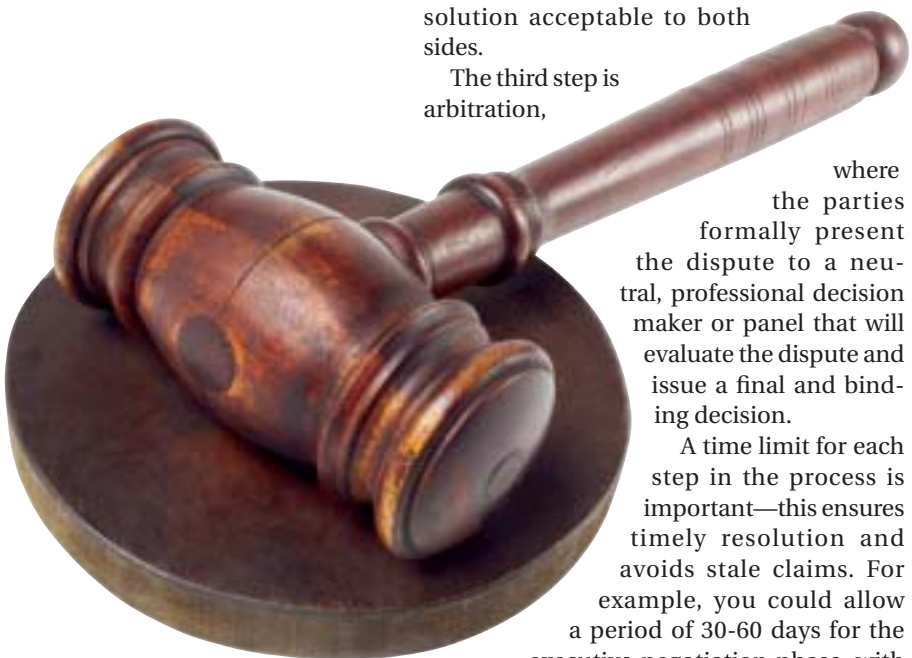
The Process

A typical dispute resolution clause in a contract provides a multi-step process with time limits for completion of each step. This is your chance to tailor the dispute resolution procedures to your particular needs before the dispute arises. In fact, this is the time to do it, before anyone has a stake in a position after a dispute arises.

If a dispute were to arise, both parties would follow a process. The first step often is negotiation between the parties by people who have higher rank in the company and who were not specifically involved with the issues giving rise to the dispute. For example, the parties could agree that the chief operating officer or his or her designee would meet first, have the opposing viewpoints presented, and then meet again to resolve the matter, through negotiation.

If the negotiation fails, the second step is mediation—a neutral professional would work with the parties to develop a solution acceptable to both sides.

The third step is arbitration, where the parties formally present the dispute to a neutral, professional decision maker or panel that will evaluate the dispute and issue a final and binding decision.



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A time limit for each step in the process is important—this ensures timely resolution and avoids stale claims. For example, you could allow a period of 30-60 days for the executive negotiation phase, with another 30-60 days for formal mediation, before the matter proceeds to arbitration. In arbitration, it also is a good idea to designate a time period for a final decision or award—say, six months. That will help avoid delay and, consequently, save on expenses—one of arbitration's main goals in the first place.

ADR and Transmission Organizations

One arena in which there has been significant growth over the last five years in the use of ADR is with independent system operators (ISOs) and regional transmission organizations (RTOs). Most have institutionalized ADR,

Finding the Expertise

Participants in energy industry alternative dispute resolution (ADR) proceedings maintain that one of the most important things is to find mediators and arbitrators with subject-matter expertise. The industry has unique issues, vocabulary, and history. In recognition of this growing need for expertise, two nonprofit dispute resolution organizations—the International Institute for Conflict Prevention & Resolution (www.cpradr.org) and the American Arbitration Association (www.adr.org)—maintain mediation and arbitration panels comprised of experts in the subject matter and the skills necessary to be effective mediators and arbitrators in the electric utility and other energy industries.

Several regional transmission organizations also have approved lists of mediators and arbitrators for use by members who have disputes involving their RTO or ISO.

More than 800 companies on behalf of themselves and their subsidiaries have signed the International Institute for Conflict Prevention & Resolution (CPR) "Corporate Policy Statement on Alternatives to Litigation," which obliges them to explore negotiation or ADR before pursuing full-scale litigation. Nearly 30 shareholder-owned electric companies are signatories to this policy, as are many of the industry's suppliers and vendors.

in one form or another, in their basic tariffs or agreements. There are many variations in the specific mechanisms—this seems to reflect the complex, multiparty, and often lengthy negotiation processes that were involved in creating each entity in the first place.

The base documents of the transmission organizations also require formal mediation, in one form or another, prior to the use of arbitration. Again, the specific details of the mediation mechanisms and the timeframes involved differ widely from organization to organization. For example, in PJM, mediation is mandatory. At the California ISO, however, confidential mediation is an "optional precursor" to any arbitration, and 75 percent of the parties involved in the dispute must consent. Similarly, the use of mediation also is determined by agreement of the parties under the Midwest ISO Transmission Owners Agreement. By contrast, the Northeast ISO does not appear to have a designed mediation step.

In each transmission organization, the procedures vary widely as to whether a sole arbitrator or a tri-partite panel is to be involved in a case. The mechanisms for selecting arbitrators and conducting proceedings also vary.

All the transmission organizations then have a formal binding arbitration mechanism as the final ADR step. In PJM, for example, disputes not settled through mediation involving under $1 million must proceed to binding arbitration, by tariff. For disputes more than $1 million, the parties have the discretion to agree to that step.

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In each transmission organization, the procedures vary widely as to whether a sole arbitrator or a tri-partite panel is to be involved in a case. The mechanisms for selecting arbitrators and conducting proceedings also vary considerably from entity to entity. In at least one case, the California ISO, arbitrations are under the auspices of the American Arbitration Association. In the New England Power Pool (NEPOOL) there is a five-member board of review responsible for issuing written advisory rulings on appeals from actions of the NEPOOL participant committee.

Another one of the variables among transmission organizations is with respect to appellate rights. Some of the arrangements describe a right to appeal to the Federal Energy Regulatory Commission (FERC), albeit with limitations. For example, the California ISO tariff provides for such a right, but specifies that FERC will "pay deference" to the arbitrator's findings of fact and the agency cannot expand the record. Arrangements at other entities

FERC Speaks on ADR

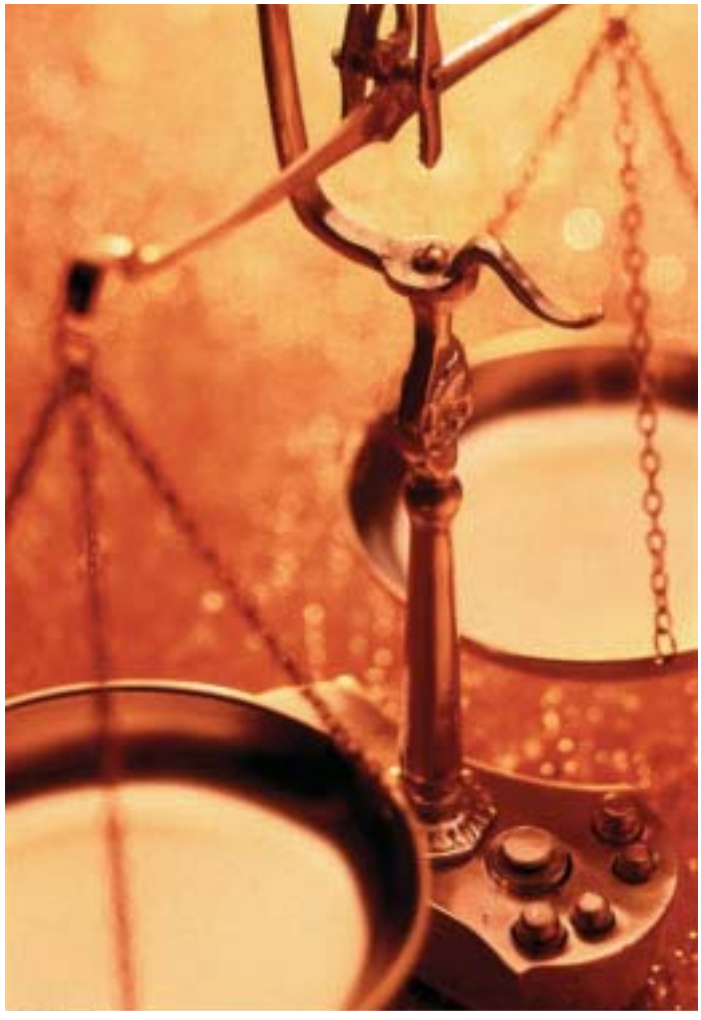
"The Commission has long recognized the value of parties seeking to resolve disputes through means other than formal litigation…and thus has stated that it is desirable and appropriate, if otherwise consistent with the public interest, for the Commission to adhere to the results of a binding arbitration award given that arbitration is a valuable way to avoid time-consuming and expensive administrative proceedings."

—from the Federal Energy Regulatory Commission's May 10, 2004 "Order Denying Petition for Review in California Independent System Operator Corporation."

require the filing of the binding arbitration result at FERC but do not specify the appeal rights or framework. Other entities' documents are totally silent on the ultimate FERC role, if any.

It is difficult to find definitive data on how many formal ADR proceedings actually have been conducted at the individual transmission organizations. But it is easy to understand how the documentation of actual ADR experience is sketchy in light of the usual confidential nature of mediations and arbitrations.

The best example, for which there are public documents available, of a transmission organization arbitration involved California's Pacific Gas & Electric, Southern California Edison, municipals, and the California ISO in 2002-2003 in a complex dispute concerning transmission charges and the California-Oregon Transmission Project. That dispute was fully arbitrated in an American Arbitration Association case, as provided in the California ISO tariff, before a sole arbitrator. Ultimately, FERC upheld the decision in the mandated arbitration, paying substantial deference to the arbitrator's detailed written award. In that case, FERC made its supportive views on arbitration clear. (See the sidebar, "FERC Speaks on ADR.") That view on arbitration as an alternative to full regulatory litigation illustrates why arbitration exists in the ISO/RTO context and will be a continuing occurrence as those transmission arrangements evolve.



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The bottom line is that ADR has become a regular fixture in the transmission arena, and there is reason to believe this will be an area of significant ADR activity in the future.

Keeping It Manageable and Finding Expert Neutrals

In business, there will always be disputed transactions that require resolution. Most executives recognize that their best interests in the long run are usually served by resolving the dispute quickly and cost-effectively while maintaining the business relationship. That is difficult, if not impossible to accomplish in traditional court or agency litigation: There has never been a "friendly lawsuit."

Indeed, ADR has become an integral part of corporate policy to achieve such corporate objectives as preserving business relationships, as well as saving time and money, controlling and reducing uncertainty and risk, and maintaining privacy and confidentiality. ◆