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Can parties be required to mediate before proceeding to arbitration?

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Client Advisories

Hughes Hubbard & Reed LLP • A New York Limited Liability Partnership
One Battery Park Plaza • New York, New York 10004-1482 • +1 (212) 837-6000

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Mediation and arbitration are both common dispute resolution methods, and both can lead to effective outcomes. Many contracts include provisions that require parties to enter into mediation or arbitration, or first one and then the other, in the event of a dispute.

What is the difference between mediation and arbitration?

Through mediation, the parties attempt to resolve their dispute through a series of conversations with each other and a neutral mediator. Although mediation has collaboration as a fundamental aspiration, these conversations can fall anywhere on the spectrum from collaborative to adversarial. The mediator facilitates the parties' discussions and assists them in trying to reach a mutual and voluntary resolution. If the parties agree on a solution, they usually opt to execute a legally binding settlement agreement.

Arbitration is more formal and adversarial than mediation and proceeds similarly to a lawsuit within a statutory framework. The arbitrator (or arbitral tribunal of, typically, three arbitrators) will review evidence, listen to arguments, and then render a binding decision that typically cannot be appealed. Both arbitrators and mediators are neutral third parties. In some industries, such as construction, both mediators and arbitrators may be chosen specifically because of their industry knowledge. This helps expedite both processes.

What is a "stepped clause" versus the "Med-Arb" approach?

When a dispute arises, some parties may prefer to begin with mediation, rather than proceeding directly to arbitration. To ensure that mediation is attempted before resorting to arbitration, the parties may include a stepped clause in their contract. A stepped clause, also referred to as a "tiered clause", may be broken into two sub-clauses, with the first resembling a standard mediation clause and the second stating that all disputes not settled through mediation will be submitted to a final, binding arbitration. In cases where mediation is unsuccessful and the parties proceed to arbitration, the arbitrator and mediator roles are typically filled by different individuals.

Other contracts adopt a hybrid mediation-arbitration approach, known as "med-arb". Med-arb clauses operate similarly to stepped clauses, but in med-arb the same individual acts as both mediator and, if the parties are unable to resolve

their issues during mediation, as arbitrator.

What are the benefits (and disadvantages) of including a stepped clause in a contract?

Stepped clauses are increasingly popular and may be suitable even for disputes under time pressure or disputes whose amount in controversy would make a full arbitration disproportionately expensive. In some cases, the threat of having an arbitrator render a final and binding decision can motivate the parties to work together in mediation. Stepped clauses can also be cost-effective as they provide the parties an opportunity to avoid the costs of a full arbitration by resolving the dispute through mediation, or at the very least to narrow the issues to be referred to an arbitrator or arbitral tribunal. And, even where mediation is unsuccessful, the process of engaging in mediation can allow the parties an opportunity to test and crystallize their arguments and marshal the necessary evidence in preparation for arbitration proceedings, as well as providing a preview of the adversary's case.

That said, stepped clauses may on occasion be frustrating to parties faced with disputes that are unlikely to be resolved in mediation, such as where mediation would be futile but is nevertheless required as a preliminary step.

What are the benefits (and disadvantages) of including med-arb clauses in a contract?

Med-arb clauses can be cost-effective because only one person is hired to serve as both mediator and arbitrator. If mediation is unsuccessful, the mediator/arbitrator is already versed in the facts and evidence of the case before the arbitration commences.

However, having one person function as both mediator and arbitrator can make parties reluctant to speak candidly during mediation, knowing that the same individual can ultimately issue a binding decision if the dispute proceeds to arbitration. This can lead to a loss of trust in the med-arb process. A stepped clause avoids these issues by having different individuals serve as mediator and arbitrator. As a result, the parties can speak freely and may be more willing to concede weaknesses in discussions with the mediator.

Are stepped clauses enforceable?

In the US, the applicable federal law on arbitration is the Federal Arbitration Act, or FAA. The FAA applies in both state and federal courts and regulates the non-judicial resolution of disputes concerning interstate commerce. The FAA does not apply to mediation. Nevertheless, courts tasked with determining whether mediation can be compelled when one party files a lawsuit or commences arbitration before attempting to mediate will generally enforce stepped clauses as a matter of contract law. In 2017, a New York court held that in a case where a contract required mediation before commencing a litigation or arbitration, the failure to exhaust the mediation process was grounds for the action being dismissed. The outcome in this case, Archstone Development LLC v. Renval Construction LLC, suggests that courts will enforce agreements to mediate as conditions precedent to agreements to arbitrate. This seems to be the majority approach, as other courts have dismissed cases where parties fail to comply with mediation clauses, and some courts have stayed cases until the contractually required mediation is completed.

Still, not every court will order mediation. In the 2008 case Trujillo, Advanced Bodycare Solutions, LLC v. Thione Int'l, Inc., a party that sought to compel mediation did not succeed because the motion was filed solely under the Federal Arbitration Act, which was not a valid basis for the mediation claim. However, the Eleventh Circuit noted in its opinion that a traditional breach of contract theory could have been a successful basis for the claim.

The cases taken together suggest that an effectively written stepped clause can essentially make mediation a requirement before any further arbitration or litigation can proceed. If a lawsuit or arbitration is commenced before mediation, arguing a traditional breach of contract theory would likely be successful in requiring the plaintiff to mediate before proceeding to arbitrate or litigate in court.

What are some considerations for when to include a stepped provision in a contract, and what to include in the clause?

Disputes relating to construction, labor, financial regulations, and other fields where preserving an ongoing relationship between the parties is important can all benefit from following a two-step process. Parties that choose to include stepped provisions in their contracts should consider whether they want to allow one individual to serve as both the mediator and potential arbitrator, or have the two roles played by separate individuals. As noted above, having one individual play the role of both arbitrator and mediator can lead to an ineffective mediation process, so parties are most often better served by appointing two different individuals. Additionally, parties who elect to include stepped provisions should be aware that, even if the relationship between the parties breaks down and mediation is unlikely to succeed, mediation must still be attempted before commencing arbitration, unless the clause explicitly allows the parties to forgo mediation where it would be futile, or where both sides agree at that point to proceed directly to arbitration. Likewise, to ensure that stepped clauses function effectively, time limits on each step can be provided for in the contract. These time limits help mitigate the possibility of a party delaying arbitration in bad faith by unreasonably prolonging the mediation.

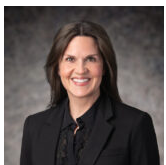
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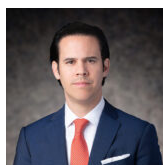
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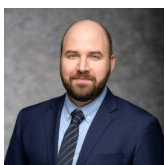
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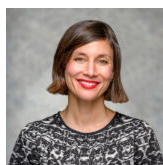
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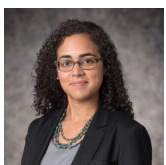
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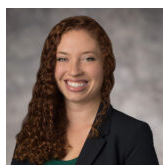
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