

Examining Mediation as the Opportunity Cost of Litigation: Can it be Sustained in the Long Term?

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Abstract

Provision for appropriate dispute resolution clauses in international commercial contracts has evolved to become an essential ingredient in contemporary competitive markets. They also serve as a pre-emptive remedy, necessitating further demands for cheaper remedies in dispute management, specifically alternative dispute resolution² processes such as arbitration, conciliation and mediation. Further, there is the question whether the business community could sustain the average commercial

fees for dispute settlement without becoming a source of resentment or revolt in the long term. This essay examines the economic cost of dispute settlement with a bias towards mediation, as well as other issues concerning creative management of disputes. This informs a more compelling need to reconsider the costs of disputes in economic terms: analysing comparative merits/utilities of mediation and determining what the opportunity cost of mediation in international commercial contracts is and whether it is cost

efficient in comparison with other forms of dispute resolution process. *'For the rational study of the law the black letter man may be the man of the present, but the man of the future is the man of statistics and master of economics. We learn that of everything we have, we have to give up something else, and we are taught to set the advantage we gain against the other advantage we lose, and to know what we are doing when we elect'*³

INTRODUCTION

It is arguable that everyone concerned with dispute resolution could reasonably view commercial litigation from two or more perspectives, particularly from an understanding and appreciation of the fact that business people do not like to spend money on litigation and other avoidable ancillary adjuncts to it. Similarly, this paper aligns with the argument that disputes or conflicts from which it might have originated are not wholly undesirable, but also have some valuable characteristics and therefore the proper function of law is to manage rather than suppress or merely resolve conflict.⁴

This article is in the context of the growing promotion and popularity of alternative means of dispute resolution in international commercial transactions in the light of the chequered history of litigation. The paper is quick to assume that there is a peculiar need for the legal profession to guarantee a sustainable and continued relevance throughout the process of making a commercial

agreement and the execution of it. This is because the cost and management of it, whether it succeeds or fails in the face of competitive commercial exigencies, is now a very strong driver for the calls for creative options in dispute resolution.

Nevertheless, legal practitioners involved in commercial practice must be able to appreciate the wisdom or logic involved in the preference or choice of any of the methods now in vogue, especially mediation in contemporary management of international commercial disputes.

The advantages inherent in this preference might appear very obvious and clearly appreciated by an avowed advocate of ADR, but these advantages or their attractiveness might not easily persuade or convince a lawyer trained in traditional adversarial legal culture. This is because the latter places a higher premium on quantum of rights, obligation, and liabilities. In the same respect, average conservative business entities involved in multi-million dollars worth of transactions have grown to rely on the established legal

system of dispute resolution (litigation) as the most predictable and reliable of dispute management that can afford them protection in case of any dispute that may arise from its transaction.⁵

Consequently, this paper aims to analyse and justify the mediation process as a viable and reasonable opportunity cost of traditional dispute resolution techniques. The paper will demonstrate its intrinsic values and utilities, which makes it most suitable for resolution of international commercial disputes.

The paper also describes the necessity for an economic analysis of dispute resolution process in the face of interplay between law and economics. When this link has been established, then the relevance of economic concepts such as scarcity, availability of resources, choice and opportunity cost in relation to the actual or accounting cost of disputes will be brought into focus. The paper further attempts to explain some apparent and latent barriers or limitations to the growth of mediation beyond its present level.

While it is trite that mediation as a form of dispute resolution has been with man since the beginning of the ages, global business diplomacy by professional mediators owes its recent growth to the two great converging forces of supply / demand – creative lawyering and cross-border trading.⁶

Based on empirical, analytical data and current economic trends, it is submitted that mediation is a more cost-efficient and dispassionate way of resolving international commercial disputes though its potentials are yet to be fully realised.⁷

WHAT IS THE RELEVANCE OF ECONOMIC ANALYSIS OF LAW TO COMMERCIAL DISPUTE?

A dispute has been defined as a controversy or disagreement on a point of law or fact, or a conflict on legal view or interests between two persons.⁸ Irrespective of the definition adopted, the basic denominator is that it would always require resolution. There are two basic ways of resolving disputes, which are the legal or judicial means and the diplomatic means, comprising ADR systems such as negotiation, conciliation and mediation.⁹ Generally, ADR was popularised in the USA in the early 1970s, and was employed to remedy the shortcomings of litigation and arbitration¹⁰, but alternatives to courts are not a novel development, rather their current resurgence adds a freshness to it.¹¹ This freshness, as the essay

will reveal, is being generated by commercial exigencies.

Generally, when disputes arise, parties to any commercial agreement would most probably want the dispute to be resolved amicably through negotiation or other methods (like good offices and conciliation) rather than an automatic demand for a legal redress. However, when these efforts prove abortive then intervention of a third party to break the impasse and bring about an acceptable solution becomes necessary. This intervention could be formal or informal, although in international business transactions formal intervention is the preferred choice. This is primarily because of the issues of degree of animosity between the parties, confidentiality and the amount of capital usually involved in the transactions: this gives the parties the impression that an air of formality lends seriousness to the issue at hand.¹²

Consequently, a process of mediation takes place via a third party who assumes the task of reconciling the opposing claims and appeasing the emotional hurt of the parties as a result of their dispute.¹³ Briefly, mediation could be defined as *'the use of a third party to help those in conflict to do things and reach agreements which, unaided, they may never do, or may do so much later in the conflict that each will have suffered further harm'*.¹⁴ There is a slight difference between mediation and 'good offices'.¹⁵

Ordinarily, dispute resolution would appear to be a matter best left under the direction of strict application of law, but according to Cooter and Ulen, *"like the rabbit in Australia, economics found a vacant niche in the 'intellectual ecology' of the law and rapidly filled it"*.¹⁶ To explain the niche, the law involves obligation backed by a state sanction; this is a case of commercial dispute which could translate to commercial obligation, breaches and consequential sanctions backed by law founded on agreement between the parties.

It is usual to inquire what the effect of a breach will entail and its cost. Economics provide scientific theory or bases to measure, analyse and possibly predict the likely costs of a dispute, for example, both the short term and long-term effect it will have on the transaction involved and possibly on the financial future of the entities concerned.

Furthermore, economics provides a useful normative standard to gauge the law and policy

behind business considerations, which could affect a business transaction or business strategy.¹⁷ In essence, the efficiency of legal or policy considerations and how they can best be suited or adapted to a transaction, coupled with the burden of such matters on business decisions can only be really appreciated when one is armed with a working knowledge of the prevailing economic climate and structures. For example, economic analysis of risk and how it can be distributed between or among parties in a project finance agreement for development of a power station involving a force-majeure clause in the agreement cannot be overemphasized.

WHAT IS THE COST OF RESOLVING AN INTERNATIONAL COMMERCIAL DISPUTE?

Just as normal business people will like to know the expected returns on their investment based on the available financial analysis of facts and figures for the purpose of determining the bankability of a project or commercial venture, in similar respect also, they will be concerned about the likely cost of any dispute that may arise from the same transaction.

The reason for this can be found in the economic connection between law and management, which is deeply rooted in the notion of scarcity of resources.

Scarcity of resources means that available resources are limited in supply, while uses for them are potentially unlimited.¹⁸ As a result demand will always outstrip supply.¹⁹

Consequently, a business entity has to make optimum use of its resources²⁰, whereby rational choices have to be made among competing alternatives based on an assumed scale or order of preference out of which funds for dispute resolution are usually at the bottom of the scale if provided for at all.²¹ However, once a dispute arises the parties involved have to make provision to sort it out.²²

This then leads to the determination of what the cost of the dispute would be, that is the actual cost or accounting cost.

According to Walde, *'even in arbitral litigation involving a case of relative value between \$5 and 10 million, the cost of the dispute might be up to \$1 million apart from other incidental costs'*.²³

However, the business entities are usually more concerned about how to reduce expenses to the barest minimum on in order to increase their

profits; thus they want the cheapest cost, which can as well offer the best results given the limited resources available.²⁴ This is because, no matter what amount of money either litigation or settlement of a dispute will cost, it will still have a negative impact on the profit margin of the transaction concerned. In essence, that would contribute to depletion in the resources of the business concerned. Yet disputes in a commercial transaction have to be resolved amid competing demands and problems seeking attention from the parties whose resources and time is limited in supply, thus making the argument for the use of the best and most cost effective method or alternative especially important.

Consequently, the choices available to the parties in a hypothetical international commercial dispute case are either the conventional legal method of dispute resolution or the diplomatic methods of ADR.

Therefore, when parties decide to choose either of the methods having weighed their respective advantages and disadvantages, they are involved in an economic analysis. Thus, the preference for mediation over litigation or arbitration explains the concept of opportunity cost in this context, i.e. the choice of mediation in preference to other available methods or alternatives that must be abandoned. Those forgone alternatives, i.e. litigation, arbitration etc. are the opportunity cost for the adoption of mediation in this scenario. Nevertheless, the real or accounting cost remains the actual monetary value that the dispute will entail, i.e. legal fees and other transactional costs.

Arguably the opportunity costs of mediation are the alternatives forgone, but the explanation for this choice lies in the intrinsic worth/value or utilities of mediation. Such an analysis is explored in the next section of this paper.

Why Choose Mediation?

The choice of mediation flows from its pre-emptive values that are discernible from its unassuming characteristics: mediation is a process in which an independent third party assists the parties in a dispute through individual meetings (caucuses) and joint sessions, to focus on their real interests and strengths as opposed to their emotions, in an attempt to draw them towards possible settlement.²⁵

'Mediation is a powerful art and structure bringing together into an open dialogue the architects and

implementers of the commercial process that is in crisis'.²⁶ Basically, mediation offers an answer on how to think about international commercial dispute resolution throughout the duration of a transaction.²⁷ It is true that 'modern arbitral litigation is a much more popular and patronised form of commercial dispute resolution, yet it is much closer to standard litigation because it tends to encompass massive costs for the litigants'.²⁸

This informs Walde's position that both litigation and arbitration indicate a serious failure of management within the organization and in the management of inter-company or company-state relationships.²⁹

Furthermore, it is clear that, with mediation, parties can keep control of the process and still be able to aim at a solution that is economically justifiable rather than just legal remedies which can further harm or damage both parties' businesses irrespective of outcome of the legal settlement envisaged.

Under certain circumstances, mediation could be the most suitable option for potential litigants and these circumstances include those situations where parties desire to maintain an amicable commercial relationship; mutual interest in a quick recognition by the parties of the prohibitive costs of litigation; desire to avoid publicity; past negative experiences from litigation; and an inability to satisfy the demands of formal judicial processes like assemblage of witnesses.³⁰

Again, another factor for the choice of mediation is the crucial role of the mediator which begins with the building of trust in her/him with a successful creation of a bridge between the disputants. Thus, a successful mediator is akin to an effective manager who has to work with a proposed business plan via a model to be designed or formulated and to be executed to make profits for the owner of the business within a competitive business environment.

Further, in manner similar to what happens in a restorative justice process, mediation affords the parties opportunities to give vent to their 'anger', disappointment, fears and suggestions. The process allows the parties some degree of contribution in resolving the dispute themselves with the aid of a mediator. This has a psychological effect on the way the parties view outcome of the dispute. Therefore, it is submitted that mediation engenders mutual respect and has an inbuilt tension

coolant that is absent in a formal adversarial process.

Nevertheless, while it is arguable that basic legal training is essential for a mediator in order to understand and appreciate the 'nitty gritty' of a commercial transaction, yet this background is not sufficient. Ironically, an ordinary legal background could at times be counter-productive because lawyers are best trained to view dispute resolution from a purely legalistic perspective without much allowance given for the economic perspective.³¹ An ideal mediator irrespective of her/his background needs sufficient experience in the field or business within which the dispute is taking place. For instance, in disputes involving petroleum or energy-related business, a mediator well versed in energy matters would be more suitable compared to a mediator who is more conversant with shipping and admiralty matters. This view is without prejudice to the general skill and experience which such mediators might possess, which also could afford them the flexibility to fit in into any dispute scenario.

Also the following virtues must be present: empathy, patience, self-assurance, clarity of thought, ingenuity and stamina. While all these qualities are very important, 'empathy', i.e. the ability to get on with the parties, appreciate their position and earn their confidence and trust, is a sterling quality that every mediator must work upon along with positive perseverance and the stamina required to reach an acceptable resolution.³²

Utility of Mediation

It is generally assumed that business people always want to continue to protect and maximize their commercial interests irrespective of business complications such as a commercial dispute. It is not surprising to hear that businesses are now showing more desire for a mediation process to be built into business arrangements. This is to complement business management in a business relationship where legal barriers cannot be allowed to distort viable commercial concerns so that established goodwill and relationship would not be allowed to be lost cheaply. Mediation visibly gives the parties the possibility of a continued business relationship via effective and non-confrontational dialogue.

Another utility or value attached to mediation that is not present with other legal methods is the

issue of confidentiality. Absolute confidentiality is guaranteed and could be achieved under mediation especially where publicity of the dispute might affect the credit rating of either of the parties. Indeed, the mediation process offers the parties all forms of confidentiality they may require much more than an arbitral process could afford to offer. Essentially, this is due to the fact that parties remain in control and can always determine the extent and form of confidential arrangements suitable to them.

Moreover, mediation is much cheaper and cost efficient compared to other methods of dispute resolution. The actual cost of the use of mediation might not be more than 18–20% of the cost of a total litigation, excluding both indirect and hard-to-quantify costs such as executive time and concentration.³³ Unfortunately it is unlikely that any serious studies on the financial cost and quantifiable risks of both litigation and arbitration have been carried out to serve as a guide.³⁴

A proper assessment of the cost of mediation might involve a comparison of the cost of mediation with expected results from it that have to be set against the cost of litigation with expected results from litigation, respectively.³⁵ However, the mere calculation of time, human resources and labour involved with the two methods will clearly reveal that mediation is far cheaper and quicker.³⁶

Furthermore, mediation has been found to increase the disputants' utilities jointly compared to other methods, which only apply 'a zero game' theory whereby one of the parties has to lose in order to give an advantage to the other. Mediation puts the two parties in a 'win-win' situation.³⁷ In this case, mediation works not just to arrive at a compromise between the parties or just to split the difference. Rather, each party is encouraged to give up what they value least and, in exchange for a greater advantage.

Also mediation has the sole advantage of being forward-looking in the sense that it looks not just at the need for a continued commercial relationship between the disputants but also at the need to maintain relationships within both, and even personal departmental relationships crossing the organizational boundaries between both parties.³⁸ This is very crucial to avoid feelings of resentment or guilt where either or both parties believe that they may have exacerbated an already poor working relationship.

Another advantage of mediation that makes it work and more desirable is its 'pressure chamber' character.³⁹ This is in a sense similar to legal proceedings but in a much more forceful way whereby parties and their mediator(s) channel their energy and desire towards a workable solution that will enhance the resolution of their dispute so that as the process progresses all facts are raised and the parties are free to bare their 'souls', prejudice, fears and opinion in a way that would not be possible and permissible during a normal litigation or arbitral proceeding, especially due to formal requirement of relevancy and admissibility of facts and evidence. In addition, apart from being cheaper, mediation like arbitration makes use of expert and management tools in a simple way that could be introduced to improve the understanding of the parties so that 'knotty' issues could be sorted out in such a way that an understandable and workable solution is reached. During this process, the mediator may be able to eradicate some of the false presuppositions held by either party, thereby facilitating a more fluid discussion and raising the possibility of a more acceptable outcome.

Barriers or Limitations to Mediation

With all the values derivable from mediation in international commercial disputes, its potential may still be thwarted by institutional prejudice and structures.

One of these barriers or limitations is because professional lawyers are in control of established dispute resolution machinery. They are also trained from scratch to make legal arguments about the legal merits of one party's case over the other party's.⁴⁰ They operate on the basis of the assumption that there are always two sides to a coin which could be argued both ways. In essence the legal practice is geared to litigation, which has a psychological influence on both the practitioners and the business people whose first point of call in the case of any dispute is their legal office for advice.⁴¹ Without setting out to be biased, it is easy for a lawyer to be selectively objective while considering his or her client's instructions. Therefore, in a process of managing their client's brief they will not hesitate to pursue the slightest chance to secure an advantage for their clients. In almost all jurisdictions, persons with legal education who arguably would be interested in

preserving the survival of the establishment are responsible both for the rules and administration of the judicial establishment.

Another limiting factor according to Professor Walde is that 'pure economics' also plays a crucial role because the legal profession 'owns', much as the investment banking community 'owns', large scale corporate transactions. Therefore, settling a dispute outside formal legal machinery means loss of earning or less money for lawyers whose remuneration depends very much on how much time and paper work could be built and billed for a matter, so naturally they tend to prefer the one that gave them more billable time, and that also requires a great deal of documentation to make and respond to.

Again, litigation has the advantage of established long history and relative reliability and predictability under a formal setting, unlike mediation that has yet to be fully embraced and incorporated into most legal education curricula, although it has been with us since time immemorial in an informal setting with little systematic study or description.⁴²

This then makes mediation appear novel, especially in many societies which have different cultural approaches to negotiation, for instance the 'Americans favour its economic flexibility and deal-making character, Japanese its amicable settlement emphasis and face saving avoidance of imposed decision'.⁴³ Not until there is a synchronisation of these cultural differences and other issues will mediation develop or gain more respect and acceptance.⁴⁴ Another reason for the slow growth of mediation is the fact that at times disputants need a public judgement or endorsement for their action and would not want to take the blame for any error or miscarriage; rather they would only want to employ mediation or other ADR for pre-trial or pre-arbitral dispute mechanism, which they believe still leaves them more room for control and change of strategy.⁴⁵ This was reflected in *Channel Tunnel Group vs. Balfour Beattie Construction and Others*.⁴⁶

Moreover, the fear of being seen as weak or looking for cheap justice, coupled with inadequate knowledge of the dynamism of mediation, is another serious barrier to its general acceptance. According to a report, when corporations use or fail to use mediation frequently, the dominant reason is always because the opposing party will not agree to it.⁴⁷

CONCLUSION

With increasing pace of liberalization it is very likely that more of the international transactions involved will call for dispute resolution. This is likely to be greatly influenced by economics because the market is becoming more competitive, calling for innovation, synergy of resources and both creative and managerial legal approach to issues would be in play. In fact, one of the world's largest infrastructure projects, i.e. the construction of the new Hong Kong airport included mediation in the finance project, underlining the importance of the method.⁴⁸

In addition, the CEDR⁴⁹ having conducted detailed studies recently and recognized the threat to the former approach to dispute resolution came up with a millennium accord principle in its belief that present-day lawyers, just like the information industry, have to be millennium compliant towards 'reducing the potential for confrontation and dispute arising from the millennium' or else their source of income will begin to diminish⁵⁰, and compliance involves embracing mediation.

Moreover, whether the opportunity cost of mediation is enough to give many legal professionals serious worries and agitate/raise the hopes of business entities, the fact remains that mediation services like all other professional and justice services need to sell and meet the needs of the international market place, and the promotion of the 'mediation' brand by publication, education, continuing education and training is a major requirement for implementing global diplomacy and continued relevance for present and upcoming legal professionals.⁵¹

Consequently, a further cost of litigation is the probability that the legal profession stands to lose a great deal if it fails to strategically embrace the phenomena of ADR, bearing in mind that many accounting and economic consulting firms are increasingly becoming interested in ADR; their interests are both as ADR practitioners and as promoters of ADR to their clients. Thus, it is becoming more apparent that the market for dispute management is becoming competitive and as this competition is evolving, the legal profession should be prepared for and be involved with the coming innovations of ADR. These innovations, irrespective of the shape they might take, will greatly determine the practice of dispute management.

Finally, for an avowed critic of ADR whose core area of specialization is litigation, this paper will advise that your practice will be enhanced by further investment in the study and acquisition of ADR skills, particularly mediation.

Notes

1. PhD student University of Glasgow, LL.M. Energy Law and Policy, University of Dundee, (oluwdareadetoro@yahoo.co.uk) I am grateful to Kerra Bazzey and Alan Glazer for their valuable comments on the earlier draft of this article.
2. Hereinafter referred to as 'ADR'.
3. Oliver Wendell Holmes, 'The path of law', 10 Harvard Law Review (1897), 474. NB. This quotation is brought in as a prelude, setting the foundation for the necessary nexus between Law, Dispute and Economics, considered in this paper as the essence of legal management of dispute. The assertion that 'a lawyer without any knowledge of mathematics would soon become an enemy of the public' has become a popular cliché. However, the position of this paper is anchored on the premise that a pragmatic application of mathematics through economics occupies a position of importance in business management and therefore the paper argues that this position impacts and will continue to impact on dispute management.
4. J. Collier and V. Lowe, *The Settlement of Disputes in International Law: Institutions And Procedures* (Oxford: Oxford University Press, 2000), 1.
5. Ibid.
6. E. Carroll & K. Mackie. *International Mediation – The Art Of Business Diplomacy* 1st edn. (The Hague, The Netherlands: Kluwer Law International, 2001), 5.
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8. J. Collier & V. Lowe, *The Settlement of Disputes in International Law*, 10.
9. J.G. Merrill, *International Dispute Settlement* (Cambridge: Cambridge University Press, 2002), 27.
10. A. Bevan, *Alternative Dispute Resolution* (London: Sweet & Maxwell, 1992), 1.
11. F.E.A. Sander. 'Alternative method of dispute resolution: an overview'. In: M. Freeman (Ed.). *Alternative Dispute Resolution* (Hants: Dartmouth Publishing Company Limited, 1997), 97.
12. This is not without merit, because human beings are psychological and we are often persuaded by the wrappings or package of a product before any the decision to buy the product.
13. Ibid.
14. A. Bevan, *Alternative Dispute Resolution*, 18.
15. Collier and Lowe, *The Settlement of Disputes in International Law*, 27.
16. R. Cooter and T. Ulen, *Law and Economics* (2nd edn) (Reading: Addison-Wesley Longman, Inc., 1996), 3.
17. Ibid.
18. R.G. Lipsey & K.A. Chrystal, *Principles Of Economics*, 10th edn. (Oxford: Oxford University Press, 2004), 4.
19. Ibid.
20. Available resources are not limited to cash at hand or available capital, rather it includes probable credit facilities and expected revenues.
21. Resources here include possible loans from banks, existing capital, debts and equity contributions by the parties to the transaction involved.
22. 'Because of the pervasive prevalence of conflict and its physical, emotional and resources costs, the solutions people seek to solve it with are those that allow them to satisfy their interests and minimize costs'-Christopher Moore, *The Mediation Process* (1986).
23. T. Walde, *Mediation/Alternative Dispute Resolution in oil and Gas and Energy Transactions: Superior to Arbitration /Litigation from a Commercial and Management Perspective*, OGEL, Vol. 1, Issue No 2 (March 2003).
24. Collier & Lowe, *The Settlement of Disputes in International Law*, 27.
25. Paul Newman, *Commercial Alternative Dispute Resolution*, 180.
26. Carroll & Mackie, *International Mediation*, 1.
27. W.F. Fox Jr., 'How to think about international commercial dispute resolution'. In: *International Trade For Non-Specialists* (Ed.). P.H. Vishny (1st edn.) 1997, 923.
28. Ibid.
29. Walde, *Mediation /alternative dispute resolution in oil and gas and energy transactions*, 3.
30. Paul Newman, *Commercial alternative dispute resolution*, 181.
31. Walde, *Mediation /alternative dispute resolution in oil and gas and energy transactions*, 3.
32. Carroll & Mackie, 37. The mediator would be the go-between who 'wears a thousand sandals' according to a Japanese saying.
33. T. Walde, *Mediation /alternative dispute resolution in oil and gas and energy transactions*, 5.
34. Ibid.
35. Ibid.
36. Ibid., his estimate for a large investment arbitration before the ISCID was \$3-5 million and that estimate has been criticized as far below the likely cost.
37. For a more detailed information and analysis on game theories: Eric Rasmusen, *Games and Information: An Introduction to Game Theory* (2nd edn. 1995).
38. T. Walde, *Mediation /alternative dispute resolution in oil and gas and energy transactions*, 6.
39. Carroll & Mackie, *International Mediation* 19.
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41. Cooter and Ulen, *Law and Economics*, 335.
42. Christopher, C. Moore, *The Mediation Process: Practical Strategy for Resolving Disputes* (2nd edn.) (San Francisco: Jossey-Bass Inc. 1996), 19.
43. Carroll & Mackie, *International Mediation*, 93.

44. For a more detailed reading on the issue of cultural perspectives 'influence on mediation', see article by Donahny, M.S., 'Seeking harmony', Journal Of The Chartered Institute of Arbitrators, 61, 4.
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48. Carroll & Mackie, *International Mediation*, 106.
49. Centre for Dispute Resolution.
50. *Ibid.*, 181.
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