



# The role of nonbinding alternative dispute resolution in litigation

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## Abstract

This paper analyzes pretrial mediation, in which a panel estimates the value of the plaintiff's claim. Each party must decide whether to accept or reject the resulting award. If either party rejects, the case proceeds on toward trial; however, most cases are ultimately settled. We develop and then test a model in which each party has private information about the claim, but the mediation panel does not. The model predicts (1) the probability that each party accepts or rejects the mediation award, and (2) if the award is rejected and the case is later settled, how the settlement payment compares to the mediation award. ©2000 Elsevier Science B.V. All rights reserved.

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## 1. Introduction

In recent years there has been a rapid growth of interest in, and use of, various methods of alternative dispute resolution. These methods include arbitration, mediation, abbreviated trial procedures, and even rent-a-judge programs. The common characteristic of these methods is that a third party offers an opinion or provides information about a dispute to the litigants.

This paper analyzes pretrial mediation. In this procedure a mediation panel offers an opinion of the value of the plaintiff's claim. The rules of mediation examined here apply to medical malpractice litigation in Michigan. As explained below, the essential

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features of these rules are used in civil litigation of all kinds, in many State and federal courts.<sup>1</sup>

After a legal claim is filed in court, it must go through mediation before it can go to trial. Each party, plaintiff and defendant, presents its case to a panel of five persons, which evaluates the claim and proposes an appropriate award (if any) for the plaintiff. Each party then decides whether to accept or reject the award. If they both accept, the case is resolved, and the defendant pays the plaintiff the amount of the award. If either party rejects, the case proceeds on toward trial.<sup>2</sup> It should be noted that each party must submit its response to the mediation award without knowing the response of the other party (a failure to respond within the prescribed period is considered a rejection).<sup>3</sup>

An important feature of this procedure is that a penalty is imposed on a party who rejects the mediation award unless the party is able to improve its position at trial. A party who rejects the mediation award must pay the costs of the opposing party unless the trial verdict turns out to be ‘more favorable’ to the rejecting party than the mediation award.<sup>4</sup> The verdict is considered ‘more favorable’ to the plaintiff if it is more than 10 percent above the mediation award, and ‘more favorable’ to a defendant if it is more than 10 percent below the mediation award.

The basic features of Michigan’s mediation program are found in many court-annexed arbitration programs in both state and federal district courts. In courts which have such programs, claims generally must be submitted to nonbinding arbitration before a trial can be requested. Typically, as in Michigan, the arbitration hearing is much briefer and more informal than a trial; the usual rules of evidence do not apply. Either party can, by requesting a trial, decline to accept the arbitration award. In many jurisdictions, as in Michigan, the arbitration panel’s decision is not admissible at trial. Often a penalty is imposed on a party who has requested a trial if he fails to improve his position at trial.<sup>5</sup> Thus the analysis

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<sup>1</sup> As of 1988, 22 States and the District of Columbia had some type of court-annexed arbitration program for civil claims (Bernstein (1993), p. 2252, n. 3). A number of federal statutes have authorized the creation or expansion of nonbinding arbitration programs in federal district courts. A 1990 report by the Federal Courts Study Committee recommended that Congress “broaden statutory authorization for local rules for alternatives and supplementary procedures in civil litigation, including rules for fee and cost incentives” (Bernstein (1993), pp. 2253–2254).

<sup>2</sup> In Michigan, unlike the situation in many other states, the mediators’ evaluation may not be introduced into evidence at trial (M.C.L.A. 600.4919(4)).

<sup>3</sup> Immediately after the responses have been received from both parties, the mediation panel informs both parties of the response of the other party. Thus a party, say a defendant, who files an acceptance knows that if the other party (the plaintiff) does not accept, she will learn that the defendant was willing to accept the amount of the mediation award. Some defendants’ lawyers told us that this potential consequence is not taken lightly, since the mediation award then becomes ‘the new minimum’ in subsequent settlement negotiations.

<sup>4</sup> Here we are simplifying matters just a little for the sake of exposition. As indicated in the text ahead, if the opposing party has also rejected the mediation award, that party is entitled to costs only if the verdict is ‘more favorable’ to that party than the mediation award.

<sup>5</sup> Many states have a rule that requires a party who requests a trial to pay her opponent’s post-arbitration attorneys’ fees, costs, or both if she fails to improve her position at trial. In some states the party who requests a trial is required to pay the cost of arbitration if she does not improve her position at trial. Bernstein (1993) (2264, n. 58) describes specific cost-shifting provisions in Arizona, California, Colorado, Florida and Hawaii. A 1990 report by the Federal Courts Study Committee recommended that federal districts that were participating in a pilot program on nonbinding arbitration should experiment with fee and cost-shifting provisions (Bernstein (1993), 2264).

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