

Negotiation



A Newsletter from
Harvard Business School Publishing
and the Program on Negotiation
at Harvard Law School

Decision-Making and Communication Strategies That Deliver Results

ARTICLE REPRINT NO. N0507D

Keep It Out of Court: Resolving Differences In-House

BY FRANK E. A. SANDER AND ROBERT C. BORDONE

For a complete list of Harvard Business
School Publishing newsletters:
<http://newsletters.harvardbusinessonline.org>

For reprint and subscription information
for *Negotiation*:
Call 800-988-0866 or 617-783-7500
<http://negotiation.harvardbusinessonline.org>

For customized and quantity orders of reprints:
Call 617-783-7626 Fax 617-783-7658
For permission to copy or republish:
Call 617-783-7587

Keep It Out of Court: Resolving Differences In-House

Business disputes are inevitable. But going to court is costly and can ruin relationships. Use a robust dispute system instead.

BY FRANK E. A. SANDER AND ROBERT C. BORDONE

WORKPLACE DISPUTES ARE INEVITABLE. Employees air grievances, consumers file lawsuits, and strategic partners threaten to fire you and hire your competitor. All too often, such conflicts end up in the courts. In addition to consuming incredible amounts of time and energy, lawsuits often ruin long-standing relationships with suppliers, customers, and shareholders.

In the March issue of *Negotiation*, our article “Early Intervention: How to Minimize the Cost of Conflict” (Reprint # N0503B) presented a new way of managing on-the-job disputes. We outlined the principles of *dispute system design* (DSD)—the process of designing and implementing an effective method for resolving the conflicts that flare up within and between organizations. (See the sidebar “DSD: An Overview.”) We encouraged managers to take the lead in their organizations as DSD architects, building systems that will forestall litigation and increase workplace satisfaction.

In this article, we move from theory to practice. Specifically, we examine how companies and industries are applying the principles of DSD in three contexts: (1) workplace conflict, (2) business-to-business or business-to-consumer disputes, and (3) disputes within complex joint ventures. Systems developed by Coca-Cola Enterprises, General Electric, and the U.S. construction industry offer three case studies of the successful use of DSD. These models can help you and your coworkers prepare for and resolve conflict wherever and whenever it may arise.

DSD and workplace conflict

One challenging application of DSD has been in the realm of employment disputes. Whether an employee is passed over for a promotion or disciplined for excessive absences, the company must have a fair and accessible program for resolving such issues before they flare into disputes.

In 2000, Coca-Cola Enterprises (CCE), having seen

other businesses inundated with employee grievances and lawsuits, developed SOLUTIONS, a comprehensive system for dealing with its own internal disputes.

A four-part program, SOLUTIONS often begins with the TALK stage, in which the parties involved in the dispute attempt to negotiate their differences. If an employee felt she had unfairly been denied a promotion, for instance, she might first have a discussion with her supervisor.

Suppose the employee leaves her supervisor’s office feeling even more frustrated. Now the dispute moves to the SUPPORT stage, in which parties seek third-party help from within CCE’s ranks. In this case, the HR department might produce detailed information on job requirements and skills to help clarify why the employee was not promoted. If the employee remains

dissatisfied, she can move to the MEDIATION stage by requesting the intervention of a company employee trained in mediation. The mediator meets with the disputants and attempts to develop a mutually satisfactory solution; he might suggest that the employee be entitled to the next available supervisory position for which she is qualified. The dispute can be taken to the next level, company-funded external mediation or arbitration, only if it involves a legal claim, such as sexual harassment or race discrimination.

CCE dedicates substantial resources, including a legal-advice benefit, toward encouraging employees to use SOLUTIONS and provides extensive training to program participants. It’s important to note that SOLUTIONS is the mandated grievance process for all present and future CCE employees. In effect, many companies now require employees to waive their right to litigation in favor of alternative dispute resolution techniques. Such policies have come under increased scrutiny from the courts, but a fair internal system that gives employees considerable decision-making power is likely to be upheld.

**Companies need fair
and accessible programs
for resolving issues
before they flare
into disputes.**

DSD and business and consumer disputes

As Mike Wheeler and Gillian Morris discuss in their Harvard Business School case study, *GE's Early Dispute Resolution Initiative* (#801395 and #801453), in 1995 General Electric applied the principles of DSD in an attempt to minimize the costs of disputes with other companies and with consumers. P. D. Villareal, then GE's counsel for litigation and legal policy, designed and implemented a system called Early Dispute Resolution, or EDR. According to Villareal, EDR treats disputes not merely as legal issues but as business and interpersonal problems. EDR is designed to resolve disputes quickly and cheaply, and save important business relationships with minimal waste of management time.

The EDR process begins with GE lawyers and managers working together to classify disputes into three levels. At Level 1, managers with the most thorough understanding of the conflict attempt to engage in discussions with the

DSD: AN OVERVIEW

The DSD approach to resolving conflict in organizations follows four steps: diagnosis, design, implementation, and evaluation. The DSD architect begins by diagnosing his company's current dispute systems to better understand how and why conflicts arise and how they are handled.

Next, he guides his organization through the process of applying the principles of dispute design to build a new system for addressing conflict. The system should allow multiple access points so that those with a grievance will use it before the dispute escalates. For example, an employee should be able to air her complaints to her supervisor, someone in the HR department, or an ombudsperson. Procedures should initially be *interest-based*—focused on shared concerns—and turning to adversarial rights- and power-based procedures such as litigation and arbitration only when necessary. Management should create incentives to encourage employees to use the system and support it by funding third-party facilitators and training programs in interest-based negotiation and mediation.

In the third stage, the DSD architect implements the system through a design committee that considers the interests of everyone in the organization. Finally, in the fourth and final stage, the organization must assess the system's effectiveness and make any needed adjustments.

disputing customer or supplier. In one case, a consortium in a North African country sued Florence, Italy-based Nuovo Pignone, a GE-owned company, for selling defective compressors; a malfunction had caused a small fire in an automobile refueling station. In Level 1 discussions, Nuovo Pignone offered to repair the device. The consortium refused the deal and demanded \$70 million in lost profits, citing gross negligence on GE's part.

The conflict then moved to Level 2, where it was assigned to a dispute resolution team (DRT). The DRT estimates the risks, opportunities, and costs of litigation; identifies the range of possibilities for monetary settlement; and brainstorms nonmonetary solutions. In the Nuovo Pignone case, the DRT consisted of an in-house counsel, the product line's business manager, and a professor familiar with Italian tort law. The group reviewed documents and spoke with witnesses to assess the merits of the case. One witness, a project engineer, admitted that the compressor had been improperly maintained "just hours before the explosion." Securing his confession allowed the team to refuse to pay for any alleged lost profits. According to Michael McIlwraith, the Nuovo Pignone counsel, the assessment resulted in significant savings for GE: "We would have had two sides negotiating out of ignorance. Maybe because of the high numbers and a concern for business relationships, we would have settled for substantially more."

By requiring management to consider the costs of a protracted dispute, Level 2 ensures that a decision to move toward litigation is intentional, rather than the result of inertia or escalation of commitment. The DRT encourages more creative solutions than corporate lawyers or the courts would typically devise. In the Nuovo Pignone case, GE offered to buy back the unused compressor for half of its purchase price and promised discounts on future equipment offers. After some back and forth between the parties, the case settled successfully.

At GE, only a small number of EDR cases reach Level 3—litigation. Careful analysis by the DRT may suggest that a court case may be the most cost-effective choice, or such disputes may involve an important legal principle.

GE's EDR system gives managers intensive training in early dispute resolution, and senior litigators take an advanced course on methods for representing clients involved in mediation and alternative dispute resolution. In addition, each GE unit delivers EDR training to employees and appoints a coordinator to spearhead the program. The EDR initiative also mandates clauses in GE's business contracts that provide for mediation as a preferred dispute resolution process. The potential for significant savings, faster resolution of claims, and improved relationships

Using Dispute Systems *(continued)*

suggests that most firms would be wise to follow GE's aggressive settlement approach. (See the sidebar "DSD and the Bottom Line".)

DSD and joint ventures

The first two DSD case studies dealt with situations in which a company needs a process in place to efficiently handle disputes once they arise. The final case focuses on resolving disputes between parties involved in large-scale joint ventures.

Consider a highway construction project involving government agencies and many contractors and subcontractors. Early on, the primary contractor discovers unanticipated soil conditions that will greatly increase his costs and the duration of the project. The contractor demands an order authorizing additional payment to cover the new costs. The government agency in charge of the project rejects the claim, insisting that the contractor should have anticipated the soil conditions when he submitted his initial bid.

In the past, the entire project might have ground to a halt for years as the parties litigated the issue. However, the U.S. construction industry has designed a new institution to forestall such conflicts: the Dispute Review Board (DRB).

Here's how it works. At the outset of any large project that could prove contentious, the primary parties set up a DRB comprising three neutral experts. The board meets regularly, sometimes with the parties involved, to learn about possible problems in advance, and receives progress reports and other key documents. The board plays an important preventive role; the conflict will be brought to the DRB only if negotiation fails.

When a dispute is presented to the DRB, its members are likely to be familiar with the situation and capable of making an on-the-spot decision, which the disputants typically agree will be nonbinding. Subsequently, any disputant could decide to take the case to court or to binding arbitration. But because of their ongoing relationship with the DRB, the parties are likely to accept and comply with its decisions.

DSD AND THE BOTTOM LINE

GE worked to ensure that its EDR system was not merely a top-down directive but a process that permeated the entire organization. Accordingly, implementation has been successful in most units. GE Counsel P. D. Villareal estimates that EDR has saved GE millions of dollars. Since 1998, GE's gross revenues have increased by 25%, while its outside counsel costs have remained flat. According to Villareal, although GE has settled most of its disputes before EDR has been needed, the cycle time of GE lawsuits has been reduced by more than 50%.

Other companies that have implemented business and consumer dispute systems have reported significant savings. Thanks to its early conflict intervention program, The Toro Company, based in Bloomington, Minn., has cut the cost of handling each claim it receives from \$115,000 to \$35,000 per claim, a savings of \$80,000.

A DRB can be formed for any large-scale joint venture, such as an agreement between an inventor and a manufacturer to develop a new product. More generally, DSD can be applied to manage all your workplace disputes, as long as it's carefully tailored to suit the individuals, organizations, and situations involved. ♦

Frank E. A. Sander is the Bussey Professor of Law at Harvard Law School and a member of the executive committee of the Program on Negotiation at Harvard Law School. He is also the co-director of the Dispute Resolution Program at Harvard Law School. **Robert C. Bordone** is the Thaddeus R. Beal Lecturer on Law at Harvard Law School and the deputy director of the Harvard Negotiation Research Project. They can be reached at negotiation@hbsp.harvard.edu.