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Contract Formation in Imperfect Markets: Should We Use Mediators in Deals?

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This Article asks a simple question: Could third-party mediators be helpful in deals, just as they are in disputes? This Article makes a theoretical argument for such interventions, but also presents preliminary empirical evidence suggesting that transactional mediation may already be taking place.

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I. INTRODUCTION

Legal scholars have recently taken new interest in complex transactions or deals. Several leading law schools now teach courses devoted to dealmaking,¹ fellowships have been created in transactional studies,² law reviews have held symposia on the topic,³ and recent books focus on the lawyer's role in transactional bargaining.⁴

Much of this scholarship has its roots in Ronald Gilson's now classic article, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*.⁵ In that article, Gilson asks how lawyers create value for their transacting clients. If the market is perfect and prices capital assets efficiently—as finance theory often assumes⁶—there is little for a lawyer to do in a commercial transaction other than engage in distributive bargaining and add transaction costs. Gilson hypothesized, however, that the market does not always price transactions efficiently. In the real world, transaction costs, information asymmetries, strategic behavior, and other barriers to efficient asset pricing sometimes stand in the way of closing deals. And in those market imperfections lie a lawyer's opportunity. A business lawyer can use representations, warranties, and other contractual devices to bring the real world's imperfect market closer to the idealized world of efficient markets.

¹ Ronald Gilson and Victor Goldberg offer a course at Columbia Law School titled Deals: The Economic Structure of Transactions and Contracting. Gilson also offers a similar course at Stanford Law School. Nancy Knauer and Eleanor Myers offer a course titled Integrated Transactional Practice at Temple University's School of Law. Cornell Law School offers courses on The Anatomy of a Deal and on The IPO Process and Deal Structure Alternatives. For a discussion of the need to incorporate deals into the traditional law school curriculum, see Victor Fleischer, *Deals: Bringing Corporate Transactions into the Law School Classroom*, 2002 COLUM. BUS. L. REV. 475 (2002).

² Information on Columbia Law School's fellowship program is available at http://www.law.columbia.edu/center_program/deals (last visited Sept. 30, 2003).

³ For example, Ronald Gilson and Robert Mnookin organized a symposium on the ways in which business lawyers add value to transactions. See Ronald J. Gilson & Robert H. Mnookin, Symposium, *Business Lawyering and Value Creation for Clients*, 74 OR. L. REV. 1 (1995). In addition, a recent Michigan Law Review symposium focused on commercial transactions. See Symposium, *Empirical Research in Commercial Transactions*, 98 MICH. L. REV. 2421 (2000).

⁴ See, e.g., DAVID G. EPSTEIN ET AL., MAKING AND DOING DEALS: CONTRACTS IN CONTEXT (2002); ROBERT H. MNOOKIN ET AL., BEYOND WINNING: NEGOTIATING TO CREATE VALUE IN DEALS AND DISPUTES (2000) (discussing dealmaking).

⁵ Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239 (1984).

⁶ Much of Gilson's article focuses on capital asset pricing theory. See *id.* at 250–51. For our purposes, there is no reason to delve into the intricacies of the model.

Gilson labeled this role “transaction cost engineering.” For example, whereas in a perfect world transacting parties would have similar information and forecasts about the future performance of a commercial asset to be traded, in the real world expectations often differ. This makes it difficult to price that asset. One side may think the asset is worth a lot because the future looks bright; the other side argues that future prospects are grim. Such differences may lead to a negotiation breakdown and no deal. Lawyers can bridge such gaps, however, using an “earnout contract” that makes payment contingent on performance.⁷ By using legal devices to minimize the impact of market imperfections, a lawyer can add value to a transaction.⁸

This Article takes Gilson’s powerful explanation of the role of lawyers in commercial transactions as the jumping-off point for a slightly different inquiry into the dynamics of dealmaking. It focuses on the following paradox implicit within Gilson’s article. On the one hand, Gilson recognizes that transaction costs, information asymmetries, and strategic behavior may keep parties from consummating deals. This is what creates an opportunity for lawyers to craft contracts that correct for these market imperfections. On the other hand, *lawyers* may also fall prey to the *same* transaction costs, information asymmetries, and strategic behavior as *they* negotiate.⁹ In other words, as lawyers try to negotiate contracts to help clients overcome these barriers to reaching a deal, these same barriers may compromise the lawyers’ ability to do so.

This does not undermine Gilson’s thesis—after all, lawyers may create *some* value for their clients through transaction cost engineering, even if these same transaction costs keep them from perfecting their task. It does raise an interesting question, however. Is there a role for a different kind of player in transactions—a player who could help parties, including business lawyers, to overcome these various market imperfections as they negotiate the terms and conditions of a deal? In particular, is there a role for *neutral* intermediaries—or mediators—in dealmaking? We do not typically assume that lawyers and clients involved in mergers and acquisitions, real estate deals, and other complex transactions will seek the assistance of a neutral mediator. But should they?

Over the past three decades, mediation has emerged as a pervasive complement to traditional litigation. Disputants now routinely use mediators to dispose of cases in a variety of contexts, including commercial litigation, environmental disputes, employment problems, and mass torts. Mediators

⁷ *Id.* at 262.

⁸ *Id.* at 300.

⁹ Gilson recognized that transactional lawyers often engage in strategic behavior. *See infra* notes 88–96 and accompanying text.

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can help disputing parties overcome information asymmetries, optimize their settlements, manage psychological barriers to negotiation, and cope with emotional and relational issues.¹⁰ In many ways, an impartial mediator is uniquely suited to help parties overcome the various transaction costs that can impede settlement.

In promoting mediation as an alternative to litigation, however, alternative dispute resolution (ADR),¹¹ contract,¹² and law and economics¹³ scholars have largely ignored the transactional realm. Although some have briefly considered the possibility of “deal mediators,”¹⁴ no one has analyzed in depth¹⁵ whether mediators can add value in closing mergers and

¹⁰ See *infra* Parts I and II.

¹¹ It is always difficult to prove a negative. Still, the literature on mediation and alternative dispute resolution fails to evidence much exploration of the use of mediators in transactions. Several major treatments of the field, for example, contain no discussion of this issue. See, e.g., EDWARD A. DAUER, *MANUAL OF DISPUTE RESOLUTION* (1994) (discussing various contexts in which mediation takes place but not mentioning transactional mediation); CHRISTOPHER W. MOORE, *THE MEDIATION PROCESS* (1996) (same); E. WENDY TRACHTE-HUBER & STEPHEN K. HUBER, *ALTERNATIVE DISPUTE RESOLUTION: STRATEGIES FOR LAW AND BUSINESS* (1996) (same).

¹² Relational contract scholars since Ian Macneil have considered the use of mediators to maintain long-term contractual relations. See, e.g., Thomas J. Stipanowich, *Contract and Conflict Management*, 2001 WIS. L. REV. 831; Thomas J. Stipanowich, *The Multi-Door Contract and Other Possibilities*, 13 OHIO ST. J. ON DISP. RESOL. 303 (1998) [hereinafter Stipanowich, *Multi-Door Contract*]; see also IAN MACNEIL, *THE NEW SOCIAL CONTRACT* (1980); Ian R. Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law*, 72 NW. U. L. REV. 854, 867 (1978). However, this literature has not explored the broader possibilities for using mediators to aid in the *creation* of transactions. The inclusion of an ADR clause is an *ex ante* means of controlling future disputing behavior through the use of mediators, not the use of a mediator as a means of arriving at satisfactory and efficient deal terms. See generally Steven Shavell, *Alternative Dispute Resolution: An Economic Analysis*, 24 J. LEGAL STUD. 1 (1995) (exploring the difference between *ex ante* and *ex post* decisions to employ mediators in a dispute resolution process).

¹³ Shavell, Ayres, and others have shown interest in the economic justifications for the use of mediation to resolve litigation, but little attention has been paid to the transactional context. See *infra* notes 24–49 and accompanying text.

¹⁴ See L. Michael Hager & Robert Pritchard, *Deal Mediation: How ADR Techniques Can Help Achieve Durable Agreements in the Global Markets*, 14 ICSID REV.-FOREIGN INVESTMENT L.J. 1, 2–3 (1999) (proposing a role for lawyer-mediators in international transactions, particularly if cultural differences exist); see also *CPR's Online Seminar: Transactional ADR*, 19 ALTERNATIVES TO HIGH COST OF LITIG., July-Aug. 2001, at 173 (transcript of panel discussion on the possibilities of transactional mediation).

¹⁵ The one major treatment of the topic is in Howard Raiffa's classic text on bargaining, where Raiffa discusses the possibility of using mediators in mergers and acquisitions. See HOWARD RAIFFA, *THE ART AND SCIENCE OF NEGOTIATION* 91–118

acquisitions, joint ventures, or employment agreements, just as they do in litigation. The few references to transactional mediation in the legal literature mention it in passing and as part of a larger discussion of settling litigation.¹⁶ In short, although it is well accepted that mediators can help to settle lawsuits, it seems equally well accepted that there is little or no role for such mediators in helping parties with commercial transactions.

This Article takes issue with this conventional wisdom. It argues that many of the same barriers to negotiation that plague litigation settlement

(1982). Additionally, in the 1970s, two authors briefly discussed the somewhat different idea of using joint representation to facilitate contracting, but neither explored the possibility of using a true mediator for such purposes. See Roland A. Paul, *A New Role for Lawyers in Contract Negotiations*, 62 A.B.A. J. 93 (1976) (lawyers as “middle counsel” or “mediators” in commercial negotiations); James C. Hagy, Note, *Simultaneous Representation: Transaction Resolution in the Adversary System*, 28 CASE W. RES. L. REV. 86 (1977). Finally, building on Raiffa’s analysis, an unpublished manuscript by two colleagues at the Harvard Business School discusses the possibility of using mediation in friendly mergers, but does not consider the full implications of introducing mediators into deals. See Guhan Subramanian & James Sebenius, *Why Friendly Mergers Fail: Barriers to Achieving Value-Creating Mergers and a Proposal for Mediation* (unpublished manuscript on file with author); see also Frank E.A. Sander & Jeffrey Z. Rubin, *The Janus Quality of Negotiation: Dealmaking and Dispute Settlement*, 4 NEGOT. J. 109 (1988) (describing the differences between dispute settlement and deal-making).

¹⁶ See CHARLES B. CRAVER, *EFFECTIVE LEGAL NEGOTIATION AND SETTLEMENT* 469–70, 492–96 (4th ed. 2001) (prescribing mediator intervention in transactions but offering no analysis of how it would benefit parties); LEONARD L. RISKIN & JAMES E. WESTBROOK, *DISPUTE RESOLUTION AND LAWYERS* 313 (2d. ed. 1997) (stating that “[i]n mediation, an impartial third party helps others negotiate to resolve a dispute or plan a transaction” but not analyzing transactional mediation); STEPHEN J. WARE, *ALTERNATIVE DISPUTE RESOLUTION* 203 (2001) (dividing mediation into transactional and dispute mediation and noting that transactional mediation is less common and “only rarely mentioned in this chapter”); Carrie Menkel-Meadow, *Ethics and Professionalism in Non-Adversarial Lawyering*, 27 FLA. ST. U. L. REV. 153, 162 (1999) (discussing “new forms of appropriate dispute resolution, even in transactional work, or ‘transactional ADR’” but not discussing transactional mediation); Carrie Menkel-Meadow, *The Lawyer as Problem-Solver and Third-Party Mediator: Creativity and Non-Partisanship in Lawyering*, 72 TEMP. L. REV. 785, 804 (1999) (mentioning that lawyer-mediators may work to solve “litigational or transactional problems” but only analyzing disputes); Leonard L. Riskin, *Understanding Mediators’ Orientations, Strategies, and Techniques: A Grid for the Perplexed*, 1 HARV. NEGOT. L. REV. 7, 19–20 (1996) (discussing the mediation of “business interests” and suggesting briefly that a mediator might assist with contract renegotiation or with the creation of a new joint venture); Jeswald W. Salacuse, *After the Contract, What? Negotiating to Work Successfully with a Foreign Partner*, 2 CAN. INT’L. LAW. 195, 198 (1997) (discussing the use of mediators in management of long-term international partnerships, but mentioning that a mediator might help in the “deal making” phase as well).

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exist in commercial transactions, *particularly* during the closing stage of a deal when lawyers attempt to negotiate terms and conditions. It further argues that a transactional mediator could help lawyers and clients to overcome such barriers. By a “transactional mediator,” I mean an impartial person or entity that intervenes in a transactional negotiation pre-closing to facilitate the creation of a durable and efficient contract.¹⁷

Although this argument is novel, it has a deep foundation in economics. Economists have recently placed increasing importance on the ways in which intermediation helps parties to transact in imperfect markets.¹⁸ When a market is plagued by some transaction cost that parties cannot overcome directly, third parties that *can* diminish that cost will arise and begin to play a role in that market. In illiquid markets, for example, an intermediary can add value by holding inventory or cash, thereby eliminating market failures that would otherwise occur if a buyer was not always available to purchase at the precise moment that a seller was ready to sell (*e.g.*, dealers in stock markets).¹⁹ In markets with high search costs, an intermediary can help to

¹⁷ My use of the term differs from those who have used the term “transactional mediation” to refer to the mediation of litigation in a discrete, problem-solving manner. They contrast this approach to their more favored “transformative” or relationship-oriented approach. *See, e.g.*, Robert A. Baruch Bush, *Handling Workplace Conflict: Why Transformative Mediation?*, 18 HOFSTRA LAB. & EMP. L.J. 367, 368–69 (2001) (distinguishing between “transactional model” [or problem-solving model] and “transformative model,” and reviewing literature on mediation). When I use the term “transactional mediation,” I am not referring to the mediator’s style or approach but instead to the substantive context in which the mediation takes place—the transactional context as opposed to litigation.

¹⁸ *See* R. Day, *On Markets in Economic Theory*, 41 J. ECON. BEHAV. & ORG. 1, 1 (2000) (“[T]heorists and experimenters have largely neglected this important aspect of the modern economy.”); Ariel Rubinstein & Asher Wolinsky, *Middlemen*, 102 Q. J. ECON. 581, 581 (1987) (“Despite the important role played by intermediation in most markets, it is largely ignored by the standard theoretical literature.”); Abdullah Yavas, *Search and Trading in Intermediated Markets*, 5 J. ECON. & MGT. STRATEGY 195, 196 (1996) (“[T]he important role played by intermediaries in most markets has been largely ignored until recently.”). For an excellent overview of intermediation in various markets, see Daniel F. Spulber, *Market Microstructure and Intermediation*, 10 J. ECON. PERSPECTIVES 135, 136–41 (1996).

¹⁹ This is the problem of the double coincidence of wants. *See id.* at 143. An intermediary can sometimes add value by providing trading immediacy. *See* Rubinstein & Wolinsky, *supra* note 18, at 581–82 (“What makes the middlemen’s activity possible is the time-consuming nature of the trade, which enables the middlemen to extract surplus in return for shortening the time period that sellers and buyers have to wait for a transaction.”); Abdullah Yavas, *The Immediacy Service of the Specialist as a Coordination Mechanism*, 10 INT’L. REV. ECON. & FIN. 205, 207 (2001) (showing that the specialist-intermediary can provide an “immediacy service” given certain matching costs).

coordinate or match parties (e.g., travel agents, employment agencies, or the multiple listing service in residential real estate). Alternatively, an intermediary can buy and sell as a principal, hold inventory, and thereby serve as a centralized and easily identifiable trading partner (e.g., the used car dealer).²⁰ In markets with asymmetric information and the possibility of “lemons,”²¹ a middleman who buys and sells goods can supply information about, or independently guarantee, product quality (e.g., dealers in antiques and fine art).²² This Article seeks to enrich our understanding of commercial transactions by focusing legal scholars on the role of a particular type of intermediary—the third-party mediator.

I begin, in Part II, by reviewing the law and economics argument for mediation in disputes. Assuming parties are rational and self-interested, how can a mediator add value to their negotiations? I discuss two central ways in which a mediator can help settle disputes: by helping parties to discover whether settlement is possible and by helping parties to optimize their settlement. I then apply these arguments to the transactional context. Part III then considers behavioral justifications for transactional mediation. I relax the rationality assumption of Part II, and explore some of the psychological, emotional, and relational barriers to agreement that can plague transactional bargaining. Part IV then presents preliminary empirical evidence suggesting that some transactional mediation already takes place. Finally, Part V uses the theoretical apparatus developed in Parts II and III to explore the implications of my argument.

²⁰ See generally Abdullah Yavas, *Middlemen in Bilateral Search Markets*, 12 J. LAB. ECON. 406 (1994) (discussing how middlemen function in markets); see Abdullah Yavas, *Search and Trading in Intermediated Markets*, 5 J. ECON. & MGT. STRATEGY 195, 196–97 (1996) (analyzing the role of matchmakers and middlemen). Much of the work on search theory originates with G.J. Stigler. G.J. Stigler, *The Economics of Information*, 69 J. POL. ECON. 213 (1961). For an overview of the literature, see Edward A. Baryla & Leonard V. Zumpano, *Buyer Search Duration in the Residential Real Estate Market: The Role of the Real Estate Agent*, 10 J. REAL EST. RES. 1 (1995).

²¹ See George A. Akerlof, *The Market for “Lemons”: Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488 (1970) (describing the now infamous “lemons problem”).

²² See Gary Biglaiser & James W. Friedman, *Adverse Selection with Competitive Inspection*, 8 J. ECON. & MGT. STRATEGY, Spring 1999, at 1, 2 (modeling the role of middlemen in inspecting quality of goods in a market with heterogeneous buyers and sellers); Gary Biglaiser, *Middlemen as Experts*, 24 RAND J. ECON. 212, 212–13 (1993) (arguing that a middleman capable of inspecting goods and establishing a reputation for honesty reduces bargaining impasse); Yiting Li, *Middlemen and Private Information*, 42 J. MONETARY ECON. 131, 132 (1998) (modeling how middlemen arise to address adverse selection and arguing that “[p]rivate information concerning the quality of goods may be the driving force behind intermediation in several markets in the real world”).

II. ECONOMIC OR STRATEGIC JUSTIFICATIONS FOR TRANSACTIONAL MEDIATION

Some are skeptical of mediation. If one assumes that rational, self-interested actors can generally bargain to efficient agreements, why involve a third party? If a mediator has no authority to bind the parties to a given outcome, then what does the mediator add—other than costs—that the parties cannot do for themselves?²³

Given this basic uncertainty about how mediation creates value even in disputes, suggesting that mediators might benefit *transactional* negotiations may seem absurd. In short, the case must be made, and made strongly, that transactional mediators could serve some useful function. In this Part, I first explore the economic argument for mediation in disputes, focusing on the ways in which a mediator can help rational parties to overcome information asymmetries and strategic bargaining behavior. I then apply that argument to the transactional context and explore whether it holds there. Although the economic analysis in this Part is complex, I ultimately conclude that neutral mediators *do* have an economic function to play in certain stages of transactions.

A. *Economic Justifications for Dispute Mediation*

The economic case for mediation rests on the assumption that mediators can help litigating parties overcome two types of bargaining failure. First, if the parties behave strategically, they may fail to reach agreement even when doing so would create gains from trade. Second, even if the parties reach a settlement, they may settle for an economically inefficient agreement. This section explores how a mediator can help to overcome both of these problems.

1. *Discovering Gains from Trade*

Theoretically, most cases should settle. Litigation is essentially a transaction in which the plaintiff attempts to sell its legal claim to the defendant. If the parties can agree on what the case is worth, they can settle and save the transaction costs of litigating to judgment.²⁴

²³ For an excellent overview of how mediators can add value, see RUSSELL KOROBKIN, *NEGOTIATION THEORY AND STRATEGY* 345–56 (2002); *see also* HOWARD RAIFFA ET AL., *NEGOTIATION ANALYSIS: THE SCIENCE AND ART OF COLLABORATIVE DECISION MAKING* 317–19 (2002) (discussing the role of a mediator).

²⁴ *See* Bruce L. Hay, *Effort, Information, Settlement, Trial*, 24 *J. LEGAL STUD.* 29, 29 (1995) (noting that settling saves litigation costs, so parties can divide surplus created

Parties sometimes fail to settle cases when doing so would be mutually beneficial, however.²⁵ Law and economics has offered various suggestions for why this might happen. In the Priest and Klein model of why some cases do not settle, bargaining failures occur when parties make inaccurate predictions about the expected value of rejecting settlement and going to court.²⁶ A plaintiff will demand no less than the plaintiff's estimate of the expected judgment minus the plaintiff's transaction costs. A defendant will offer no more than the defendant's estimate of the judgment plus transaction costs. So long as their net estimates overlap, they will settle. But if uncertainty is great about what a court will do or what the costs will be, the parties may not find a mutually-satisfactory agreement. They may be unable to agree on what the case is worth.

Parties may also fail to settle if they negotiate strategically to try to capture greater gains for themselves. The parties may agree on case valuation—thus eliminating Priest and Klein's problem—but fail to agree on how to *divide* their transaction cost savings.²⁷ The plaintiff may make an exaggerated demand, hoping to secure a more favorable settlement. The defendant may counter with an unreasonably low offer, likewise hoping to pressure the plaintiff to concede. If each holds firm, they may not be able to settle.

Such strategic bargaining is possible because valuing litigation presents a classic adverse selection problem.²⁸ In valuing the plaintiff's legal

by not litigating); Shavell, *supra* note 12, at 11 (arguing that unless the difference between the plaintiff's and defendant's expected judgments exceeds the sum of their trial costs, the parties will settle to save such costs).

²⁵ Not *all* cases should settle, of course. In some cases a party's interests can be best served by getting his day in court or by refusing to back down on a matter of principle. See MNOOKIN ET AL., *supra* note 4, at 107 (discussing why some cases shouldn't settle).

²⁶ See George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1, 3 (1984); see also Joel Waldfogel, *Reconciling Asymmetric Information and Divergent Expectations Theories of Litigation*, 41 J.L. & ECON. 451, 457-66, 471-74 (1998) (offering evidence in support of Priest and Klein's divergent expectations theory).

²⁷ See Thomas S. Ulen, *Rational Choice and the Economic Analysis of the Law*, 19 LAW & SOC. INQUIRY 487, 496 (1994) ("Rational choice offers no theory of the particular proportions in which voluntary traders will divide a cooperative surplus.").

²⁸ Adverse selection problems occur prior to a transaction when information asymmetries permit a party who is likely to produce an adverse outcome to nevertheless transact *as if* that party were not of the adverse type. For example, if insurance companies cannot differentiate between healthy and unhealthy consumers, an unhealthy consumer can pass itself off as a healthy one, thereby paying lower premiums. Moral hazard is the problem created *after* a transaction, when a contract shifts risk from one party to another and information asymmetries permit the non-riskbearer to behave adversely under the contract without detection or consequence. Insurance again provides the classic example.

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entitlement or claim, the parties must determine its quality or merits. Each side may have private information that bears on the claim's value, however, and each has incentives to manipulate the other side's perception of that value.²⁹ To do this, each side tries to keep private its true reservation price.³⁰ The defendant does not want the plaintiff to know how much the defendant will spend, and the plaintiff does not want the defendant to know how little the plaintiff will accept. Each therefore makes exaggerated offers or demands to hide its true reservation price.³¹ As they haggle, sometimes these strategic maneuvers create deadlock and prevent settlement.³²

A mediator can mitigate strategic posturing and help disputing parties discover whether settlement is possible. The mediator can do this by managing the transfer of information.³³ Thomas Schelling recognized this

As soon as I am insured, I may drive more daringly, knowing that some of the costs of my risk-taking will be borne by the insurance company. For an overview of adverse selection and moral hazard problems, see Kenneth J. Arrow, *Information and Economic Behavior*, in 4 THE ECONOMICS OF INFORMATION: COLLECTED PAPERS OF KENNETH J. ARROW 136, 147–51 (1984).

²⁹ See MNOOKIN ET AL., *supra* note 4, at 111–12 (discussing litigants' attempts to influence others' perceptions of case value).

³⁰ A reservation price is the maximum that a buyer is willing to pay or the minimum that a seller is willing to accept.

³¹ See Jennifer Gerarda Brown & Ian Ayres, *Economic Rationales for Mediation*, 80 VA. L. REV. 323, 339–40 (1994) (providing a model of how adverse selection sacrifices gains from trade).

³² See Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950, 972–77 (1979) (discussing various strategic behaviors and noting that parties may attempt to extract greater gains by threatening to go to court even if the outcome is uncertain). A vast game theoretic literature has now examined the strategic nature of bargaining. See, e.g., GAME-THEORETIC MODELS OF BARGAINING (Alvin E. Roth ed., 1985).

It is difficult to measure the incidence of strategic behavior in legal disputes. One study of over 1,600 cases compared plaintiffs' initial demands to their attorneys' private assessments (assessed through interviews) of case value. In 41% of tort cases, demands were less than or equal to the lawyer's true estimate. At the same time, 14% of lawyers reported demanding at least twice their true estimation of case value. And 37% of defense lawyers reported that their lowest settlement offer was half or less of their true estimation of case value. See Theodore Eisenberg, *Negotiation, Lawyering, and Adjudication: Kritzer on Brokers and Deals*, 19 LAW & SOC. INQUIRY 275, 285 (1994) (citing HERBERT M. KRITZER, LET'S MAKE A DEAL: UNDERSTANDING THE NEGOTIATION PROCESS IN ORDINARY LITIGATION 49 (1991)); see also Samuel R. Gross & Kent D. Syverud, *Getting to No: A Study of Settlement Negotiations and the Selection of Cases for Trial*, 90 MICH. L. REV. 319, 343–46 (1991) (describing that in 25% of studied personal injury cases, the defendant's final offer is \$0, which is by definition a strategic final offer because it fails to account for the costs and fees a defendant will surely incur if the case is tried).

³³ In the legal scholarship, Shavell is credited with the first fairly complete analysis

role for mediators in his classic work on bargaining theory, and the argument has been recently revived.³⁴ As Schelling explains:

A mediator can consummate certain communications while blocking off certain facilities for memory. (In this regard he serves a function that can be reproduced by a computing machine.) He can, for example, compare two parties' offers to each other, declaring whether or not the offers are compatible without revealing the actual offers. He is a scanning device that can suppress part of the information put into it. He makes possible certain limited comparisons that are beyond the mental powers of the participants, since no player can persuasively commit himself to forget something.³⁵

of the economic benefits of nonbinding mediation. See Shavell, *supra* note 12, at 5–7 (exploring various types of benefits). Brown and Ayres further explored the ways in which a nonbinding mediator can improve upon the outcomes of various common games. See Brown & Ayres, *supra* note 31, at 393, 394 (finding that mediation can mitigate adverse selection and moral hazard in various games, as well as create value by mediating the flow of information between parties); see also Stephen J. Spurr, *The Role of Nonbinding Alternative Dispute Resolution in Litigation*, 42 J. ECON. BEHAV. & ORG. 75, 76–77 (2000) (analyzing mediation program in which a panel of mediators evaluates a legal claim and proposes a settlement figure); Richard A. Posner, *The Summary Jury Trial and Other Methods of Alternative Dispute Resolution: Some Cautionary Observations*, 53 U. CHI. L. REV. 366 (1986) (considering possibility that summary jury trials promote convergence of beliefs and thereby promote settlement). In general, very little research has been done on this topic. See ABHINAY MUTHOO, BARGAINING THEORY WITH APPLICATIONS 338 (1999) (noting that “[t]he role of arbitrators and mediators on the bargaining outcome is [an] area that needs much research”).

³⁴ See Avinash Dixit & Barry Nalebuff, *Making Strategies Credible*, in STRATEGY AND CHOICE 161 (Richard J. Zeckhauser ed., 1991) (discussing mediation as a coordination mechanism); Robert H. Gertner & Geoffrey P. Miller, *Settlement Escrows*, 24 J. LEGAL STUD. 87, 120–21 (1995) (exploring how a mediator may serve as an informational escrow to facilitate settlement and comparing mediation to settlement escrows).

³⁵ THOMAS C. SCHELLING, THE STRATEGY OF CONFLICT 144–45 (1960); see also DAVID A. LAX & JAMES K. SEBENIUS, MANAGER AS NEGOTIATOR 172 (1986) (“By acting as a selective conduit of information, a third party can reduce the expected or feared cost of disclosing information.”).

Schelling's comment that a mediator is akin to a computing machine is strangely prescient. Various web sites now offer “mediation” services of exactly this type: comparing offers and counteroffers and revealing settlement only if the parties' offers overlap. See ETHAN KATSH & JANET RIFKIN, ONLINE DISPUTE RESOLUTION: RESOLVING CONFLICTS IN CYBERSPACE 61–63 (2001) (describing blind bidding systems); ALAN SCOTT RAU ET AL., PROCESSES OF DISPUTE RESOLUTION: THE ROLE OF LAWYERS 124–25, 337 (3d ed. 2001) (discussing these web services); Robert C. Bordone, *Electronic Online Dispute Resolution: A Systems Approach—Potential, Problems, and a Proposal*, 3 HARV. NEGOT. L. REV. 175 (1998) (same).

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Jennifer Brown and Ian Ayres have explained this intuition in more formal terms. They suggest that sequential caucusing in mediation can help to mitigate the effects of adverse selection.³⁶ First, a mediator can receive confidential information from each side and determine independently whether gains from trade exist. The presence of a mediator allows the parties to make unobservable concessions.³⁷ Each side can signal willingness to compromise without fear that their signal will go unreciprocated, because the mediator will mute communications and only disclose information when the parties' offers overlap. Brown and Ayres argue that if the mediator commits in advance to breaking off negotiations if the parties' offers fail to overlap,³⁸ then the parties will have an incentive to represent their reservation prices more accurately to the mediator than they might to each other face-to-face. Put differently, the threat that a lack of overlap will end the bargaining creates an incentive to be reasonable, which counters the strategic incentive to misrepresent one's type as a high-value or low-value buyer or seller.³⁹

In addition, if the mediator commits to convey information imprecisely, parties may disclose information to a mediator more accurately than they would to each other. A party is unlikely to disclose her true reservation price to the mediator if she believes that the mediator will then share that information with her counterpart. But if the mediator commits credibly either to add to or to distort that information, such as by telling the other side "Party A is willing to pay something less than $\$X+20$ " rather than the more precise "Party A is willing to pay $\$X$," then the party may disclose truthfully to the mediator.⁴⁰ Alternately, a mediator might try to find an acceptable agreement by interviewing each side about possible concessions and then presenting each side with *several* solutions, some of which one side or the other had proposed, and some of which the mediator had created herself. If the

³⁶ See Brown & Ayres, *supra* note 31, at 327–28.

³⁷ For a similar formal analysis of mediators serving as a passive auctioneer who compares offers and only announces when offers overlap, see Xavier Jarque et al., *Mediation: Incomplete Information Bargaining with Filtered Communication* (2000) (working paper from *Unitat de Fonaments de l'Anàlisi Econòmica* (UAB) and *Institut d'Anàlisi Econòmica* (CSIC), on file with author). See also Charles A. Wilson, *Mediation and the Nash Bargaining Solution*, 6 *REV. ECON. DESIGN* 353, 353–54 (2001) (analyzing bargaining with a mediator who makes random proposals until agreement is reached).

³⁸ Of course, it may be difficult for a mediator to commit credibly to terminate all negotiations between the parties if there is no overlap. In the transactional context, the mediator might have to take a hostage—such as a posted bond—from the parties, which they would lose if they continued to negotiate after the mediation concluded. See Brown & Ayres, *supra* note 31, at 354 (discussing using hostages for this purpose).

³⁹ See *id.* at 335.

⁴⁰ See *id.* at 358–59.

mediator keeps the origin of each proposal confidential and merely tests for acceptability, she could uncover an agreement without disclosing information about either side's reservation price to the other. Again, with accurate information about each side's valuation, the mediator may then be able to signal that gains from trade exist. In this way, mediation may reduce the costs of bargaining.

2. *Optimizing Gains from Trade*

Sometimes in litigation, more for one party necessarily means less for the other. In other cases, however, parties can trade on differences between their resources, needs, and preferences to "create value" or reach Pareto-efficient solutions.⁴¹ Much bargaining scholarship is concerned with whether negotiators reach such efficient agreements, why they might not, and how to help them do so more frequently.⁴² Information asymmetries are again the culprit. To find trades, parties must share information about their needs and preferences. But negotiators are often reluctant to do so. Empirical studies show that negotiators both seek and provide far less information about each others' interests and priorities than one might expect.⁴³ One common explanation is that offering information freely makes you vulnerable: the other side may use information about your priorities to extract concessions.⁴⁴ Parties may therefore withhold information, preventing the discovery of value-creating trades.

⁴¹ An agreement is Pareto efficient if there is no other possible agreement that can make one party better off without making another party worse off. *See, e.g.*, RAIFFA, *supra* note 15, at 156–64 (discussing Pareto-efficiency in negotiations).

⁴² *See* LAX & SEBENIUS, *supra* note 35, at 88–116 (describing different sources of value in transactions, including differences between the parties, similarities, and economies of scale and scope); MNOOKIN ET AL., *supra* note 4, at 14–16 (same). For an excellent overview of joint-gain opportunities in the transactional arena, see David A. Lax & James K. Sebenius, *Dealcrafting: The Substance of Three-Dimensional Negotiations*, NEGOT. J., Jan. 2002, at 5, 12–25.

⁴³ *See, e.g.*, Leigh L. Thompson, *Information Exchange in Negotiation*, 27 J. EXPER. SOC. PSYCHOL. 161, 177 (1991) (“[T]hese findings suggest that information exchange is difficult to elicit in negotiation and that negotiators may even resist or avoid information exchange.”).

⁴⁴ *See* MAX H. BAZERMAN & MARGARET A. NEALE, NEGOTIATING RATIONALLY 72–76 (1992) (discussing obstacles to integrative negotiations); LAX & SEBENIUS, *supra* note 35, at 172 (noting that negotiators are “reluctant to reveal their preferences and beliefs because they fear that such disclosures will be exploited”); MNOOKIN ET AL., *supra* note 4, at 12–23 (discussing tension between creating and distributing value).

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A mediator can sometimes overcome this second bargaining problem by helping parties to find efficient trades that they might otherwise overlook.⁴⁵ A divorcing couple, for example, can optimize their child visitation schedule if they can discover that rather than following the custom of alternating major holidays with the children, both would prefer the father to take the kids for three weeks in the summer (when the mother likes to take long sailing trips) in exchange for allowing the mother to have them for both Thanksgiving and their winter vacation (when the father likes to ski). Each might be reluctant to make this suggestion, however, for fear that it will signal weakness or a willingness to compromise on visitation. A mediator might be able to interview the mother and father privately and discover these preferences. The mediator may thus identify or help the parties to identify this value-creating alteration to the standard visitation schedule.⁴⁶ Similarly, litigants can create value through structured payments that spread compensation over time⁴⁷; a contingent agreement that overcomes different expectations about future events⁴⁸; or creative provisions—such as an apology—that trade on intangible interests otherwise difficult to discern.⁴⁹ Although strategic bargaining may often prevent exploiting such opportunities to create value, a mediator’s informational advantage may discover them.

⁴⁵ See, e.g., BERNARD MAYER, *THE DYNAMICS OF CONFLICT RESOLUTION* 208–09 (2000) (discussing ways in which a mediator can encourage creativity); LAX & SEBENIUS, *supra* note 35, at 173 (“[B]ecause the mediator may know more about all the negotiator’s preferences and beliefs than any single person does, he may be able to suggest mutually beneficial provisions that the others might not think possible.”); CHRISTOPHER W. MOORE, *THE MEDIATION PROCESS* 250–61 (1996) (discussing procedures for generating creative solutions in disputes).

⁴⁶ See Craig A. McEwen & Roselle L. Wissler, *Finding Out if It’s True: Comparing Mediation and Negotiation Through Research*, 2002 J. DISP. RESOL. 133, 137–38 (discussing that parties may disclose more information to a mediator than to each other and that a mediator can use such information to come up with creative solutions).

⁴⁷ See Donald G. Gifford, *A Context-Based Theory of Strategy Selection in Legal Negotiation*, 46 OHIO ST. L.J. 41, 69 n.225 (1985) (discussing structured settlements and providing citations).

⁴⁸ See Max H. Bazerman & James J. Gillespie, *Betting on the Future: The Virtues of Contingent Contracts*, HARV. BUS. REV., Sept.–Oct. 1999, at 155, 156–60 (suggesting contingent contracts as a means to resolve antitrust litigation against IBM in the 1980s and against Microsoft in the 1990s); see also James D. Miller, *Using Lotteries to Expand the Range of Litigation Settlements*, 26 J. LEGAL STUD. 69, 69–71 (1997) (describing ways in which bets might facilitate settlement).

⁴⁹ On the role of apology in litigation and mediation, see Jonathan R. Cohen, *Advising Clients to Apologize*, 72 S. CAL. L. REV. 1009, 1036–39 (1999) (exploring the complexities of apology and arguing that mediation allows parties to reach this sometimes value-creating solution).

B. *Economic Justifications for Transactional Mediation*

1. *Discovering and Optimizing Gains from Trade*

Transactional negotiators theoretically face similar adverse selection problems to those faced by disputing parties. First, the parties may not discover that trade is possible. Just as a litigating defendant may posture and bluff to try to low-ball a plaintiff, a buyer in a transaction may be tempted to try to get a better deal by “looking cheap.” In other words, even if a buyer is willing to pay a high price, she may do better by looking as if she will only pay a low one. The opposite is true of sellers. One common example from the transactional context illustrates the problem. Because a high-value buyer does not want to signal his type to the seller, and because a seller is likely to equate having deep pockets with a willingness to spend, a deep-pocketed buyer may seek to hide its identity to prevent giving away too much to the seller. In this case an agent—such as an attorney—can be used to present an anonymous offer, thereby eliminating any signal about reservation price that might be inferred from the buyer’s identity.⁵⁰ An agent cannot, however, overcome the more basic adverse selection problem caused by the simple fact that making *any* offer sends information about the offeror’s previously private reservation price. Information asymmetries may thus lead parties to exaggerate offers and demands in order to get a better deal.

In one experiment, for example, small teams of experienced executives were given detailed information about two simulated companies. They were then assigned to represent one company or the other and asked to evaluate the companies and negotiate a merger. Although agreement was possible, only nine of the twenty-one pairings reached agreement. In addition, the executives disagreed wildly about the relevant valuations—selling prices ranged from \$3.3 million to \$16.5 million.⁵¹ This suggests that occasionally transacting parties fail to “close the deal” because of strategic posturing.

Second, as in litigation, transacting parties may fail to find Pareto-efficient agreements. In an idealized situation with full information and zero transaction costs, the parties should trade until they find an economically efficient contract.⁵² It is notoriously unclear, however, whether contracting

⁵⁰ In a sense, the attorney in this example *is* serving as a mediator. See SCHELLING, *supra* note 35, at 145 (“The use of mediators to forestall identification seems to be a common tactic when a buyer of large resources thinks a painting or a right-of-way can be bought cheap if the owner is unaware who it is that is interested.”).

⁵¹ RAIFFA, *supra* note 15, at 94–95.

⁵² Under these assumptions, there is no reason for two parties to stop bargaining until they have optimized their gains from trade. Given the choice between accepting Solution A and continuing to bargain towards Solution B, which is better for one or both

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parties reach Pareto-efficient agreements in practice.⁵³ Information asymmetries and strategic posturing may again lead to inefficiencies. Two parties may not discover an efficient agreement if one or the other is reluctant to discuss it (or agreements of its type) for fear that doing so will reveal private information about the party's reservation price.

An executive negotiating her employment agreement, for example, might shy away from discussing certain packages that involve accepting a lower salary in exchange for better benefits or greater stock options, if the executive fears that doing so would send an unwise signal about her worth. Similarly, an experiment in the corporate acquisitions context suggests that even when experienced negotiators reach agreement, they do not necessarily reach Pareto-efficient contracts. Even subjects trained in decision analysis and finance succumbed to the strategic difficulties inherent in bargaining and, because of a failure to share information, sometimes concluded inefficient deals.⁵⁴

As in litigation, a mediator should be able to help. Interestingly, the researcher in this corporate acquisitions experiment re-ran the simulation offering each negotiating pair the service of a trained mediator, but not requiring that they use the mediator. Those executives that made use of the

than A, rational negotiators should seek Solution B. The devil, of course, is in one's assumptions.

⁵³ See, e.g., John J. Donohue III, *Diverting the Coasean River: Incentive Schemes to Reduce Unemployment Spells*, 99 YALE L.J. 549, 606 (1989) (reviewing empirical evidence in employment bargaining context that questions basic Coasean assumptions).

⁵⁴ RAIFFA, *supra* note 15, at 100–01 (describing an experiment with an acquisition requiring contingent contracting). Asymmetric information models of strategic behavior indicate that inefficiency is a common outcome. See Joseph Farrell, *Information and the Coase Theorem*, 1 J. ECON. PERSP., Fall 1987, at 113, 113; see also Robert Cooter, *The Cost of Coase*, 11 J. LEGAL STUD. 1, 23 (1982) (noting that strategic behavior over dividing the pie may inhibit Coasean bargaining); Ward Farnsworth, *Do Parties to Nuisance Cases Bargain After Judgment? A Glimpse Inside the Cathedral*, 66 U. CHI. L. REV. 373, 384 (1999) (suggesting that parties do not bargain after judgment, contrary to the Coase theorem). Psychological research also indicates that subjects sometimes arrive at “lose-lose” outcomes. See generally, Leigh Thompson & Dennis Hrebec, *Lose-Lose Agreements in Interdependent Decision Making*, 120 PSYCHOL. BULL. 396 (1996) (reporting that lose-lose outcomes occurred 20% of the time in a study of over 5,000 subjects negotiating a simulation in which they had compatible preferences). Other studies indicate the opposite. Some experimental studies show that parties generally reach efficient outcomes, although they may not distribute the gains from trade evenly. See Elizabeth Hoffman & Matthew L. Spitzer, *The Coase Theorem: Some Experimental Tests*, 25 J.L. & ECON. 73 (1982); J. Keith Murnighan et al., *The Information Dilemma in Negotiations: Effects of Experience, Incentives, and Integrative Potential*, 10 INTL. J. CONFLICT MGT. 313, 331–32 (1999).

mediator reached more efficient contracts than those that did not.⁵⁵ Similarly, Max Bazerman et al. found that a mediator intermediary—as opposed to an agent—can lower impasse rates in transactional bargaining.⁵⁶ Although experimental economics regarding the role of mediators and intermediaries is in its infancy,⁵⁷ and some research suggests that intermediaries merely add costs and thus preclude agreement in some bargaining,⁵⁸ there is at least preliminary evidence that a transactional mediator can add value.

For example, as part of a larger project on fair division procedures, Steven Brams and Alan Taylor note that a mediator should theoretically be able to help merging companies resolve disagreements over “social issues,” such as how to name the post-merger corporation, how to resolve status and position questions (*e.g.*, who will be CEO), and where to locate the new company’s headquarters.⁵⁹ After reviewing a sample of large mergers that collapsed because of disputes over such issues, they concluded that “[t]hese deals highlight the need for effective dispute-resolution techniques in merger negotiations.”⁶⁰ Their “adjusted winner” procedure is designed to reduce deal failure and optimize the efficiency of trades about these social issues.⁶¹ The parties assign points to the various issues in contention and a mediator referee then uses their assignments to plumb for the most value-creating solutions to their disagreements.⁶²

⁵⁵ RAIFFA, *supra* note 15, at 102.

⁵⁶ See Max H. Bazerman et al., *The Effects of Agents and Mediators on Negotiation Outcomes*, 53 *ORG. BEHAV. & HUMAN DECISION PROCESSES* 55, 64 (1992) (finding weak support for the notion that mediators will lower impasse rates).

⁵⁷ See Abdullah Yavas et al., *An Experimental Analysis of the Impact of Intermediaries on the Outcome of Bargaining Games*, 29 *REAL ESTATE ECON.* 251, 252 (2001) (“To our knowledge, this is the first attempt to provide an experimental analysis of the role of brokers in bargaining games.”).

⁵⁸ See *id.* at 272 (concluding that a broker-intermediary merely reduces the likelihood of successful negotiation and increases sale price, but focusing on agent-intermediaries paid a percentage of sale price by the seller).

⁵⁹ STEVEN J. BRAMS & ALAN D. TAYLOR, *THE WIN-WIN SOLUTION: GUARANTEEING FAIR SHARES TO EVERYBODY* 125–30 (1999).

⁶⁰ *Id.* at 132.

⁶¹ See *id.* at 69–88 (describing the procedure).

⁶² Although parties may sometimes be able to make use of adjusted winner without a referee, using a mediator permits the parties to avoid disclosing information to each other about their relative preferences. Instead, the referee merely uses this information to find trades, disclosing solutions to the parties but keeping private the parties’ underlying priorities. See *id.* at 118 (discussing why a mediator might add value by keeping certain information private).

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Howard Raiffa also suggests that a mediator might serve as a “contract embellisher” in transactions.⁶³ He suggests that at the start of bargaining a mediator could privately interview each party about its needs, priorities, and perceptions. The mediator would lock away that information and the parties would be left alone to negotiate a deal. At the conclusion of their negotiation, but prior to closing the deal, the intervenor would return. After examining the terms of the parties’ agreement, the intervenor would try to use his private information about the parties’ interests to craft a superior deal. He would then show his substitute agreement to each party privately. If both sides agreed that the mediator’s suggestion was superior to their own contract, the substitution would be made. There would be no haggling about the terms of the mediator’s proposal—it would be a take-it-or-leave-it situation.

It is difficult to know whether Raiffa’s intervenor would succeed in practice.⁶⁴ Nevertheless, the role is certainly plausible. A skilled mediator might find trades or packages that the parties had overlooked because of carelessness, time pressures, limited skills or experience, or strategic posturing.

⁶³ See RAIFFA, *supra* note 15, at 221; see also Max H. Bazerman et al., *Post-Settlement Settlements in Two-Party Negotiations*, 3 NEGOT. J. 283 (1987); Robert W. Mendenhall, *Post-Settlement Settlements: Agreeing to Make Resolutions Efficient*, 1996 J. DISP. RESOL. 81 (reviewing the concept of post-settlement settlement and offering critique); Howard Raiffa, *Post-Settlement Settlements*, 1 NEGOT. J. 9 (1985) (describing the same role).

⁶⁴ This second stage might create incentives to behave opportunistically in the initial face-to-face negotiations. See LAX & SEBENIUS, *supra* note 35, at 180–81 (discussing Raiffa’s proposal); Orley Ashenfelter et al., *An Experimental Comparison of Dispute Rates in Alternative Arbitration Systems*, 60 ECONOMETRICA 1407, 1416–19 (1992) (suggesting that bargainers have more difficulty reaching agreement on their own if they know that an arbitrator will be available later). It seems unlikely, however, that any exacerbation would be severe. See David W. Grigsby & William J. Bigoness, *Effects of Mediation and Alternative Forms of Arbitration on Bargaining Behavior: A Laboratory Study*, 67 J. APPLIED PSYCHOL. 549, 552–53 (1982) (finding that bargainers anticipating mediation after dyadic negotiation were just as cooperative as those not anticipating mediation, although the result may be attributable to a later arbitration stage). The second stage merely optimizes upon the first. A negotiator in this scheme would know, just as he knows *without* Raiffa’s optimizer in place, that self-interested attempts to claim value run the risk of shrinking the pie and thus leading to a worse result, even from the self-interested point of view. Of course, there is no guarantee that Raiffa’s optimizer will be able to cure any such bargaining failure.

2. *Litigation Settlements and Bilateral Monopoly*

So far I have suggested that transactional negotiators face the same economic or informational barriers to agreement faced by disputing negotiators and that a mediator may thus be as valuable in the transactional arena. Although this basic case for transactional mediation is sound, it is overly simple. To deepen this initial analysis of how transactional mediators might dampen strategic behavior by controlling information exchange, we must examine under what market conditions the argument that “mediators add value by mitigating adverse selection” will hold.

Contracting takes place in a spectrum of market conditions. At one end of the spectrum lie classical contracts in well-oiled markets with large numbers competition, such as commodities markets. Each contract is discrete and there is good reason to believe that the market can price efficiently. At the other end of the spectrum, parties bargain under bilateral monopoly conditions. In a bilateral monopoly, there is only one seller and only one buyer. In other words, there is no market to establish a market price. There are no external bargaining alternatives that will drive the price towards the seller’s marginal cost (or reservation price). Instead, the valuation task is highly interdependent: buyer and seller must make offers and demands based on how much they know about the other’s reservation price. The seller wants to demand as much as possible given what she knows about the buyer’s reservation price, and the buyer wants to offer as little as possible given what he knows about the seller’s reservation price. The consequence is pricing indeterminacy. Economic theory cannot determine the outcome of bilateral monopoly bargaining. Instead, the outcome of bilateral monopoly bargaining depends on the negotiators’ ability to wield bargaining power⁶⁵ and invoke procedural and substantive norms of bargaining to their advantage.⁶⁶

In a competitive market, by contrast, the buyer’s subjective valuation is not particularly significant to the seller’s pricing decision. Although the seller might find a buyer willing to transact at above market price, the seller knows that actually setting the sale price above market is unlikely to succeed because of the presence of alternate sellers willing to undercut such a decision and price at marginal cost. Put differently, a competitive market will discipline negotiators to bargain reasonably. As Oliver Williamson put it:

Opportunistic inclinations by themselves . . . are not sufficient for an opportunism problem to be posed. It is further necessary to stipulate that a

⁶⁵ In general, “bargaining power” refers to the ability to impose costs on the other party and to absorb costs imposed by the other.

⁶⁶ See Russell Korobkin, *A Positive Theory of Legal Negotiation*, 88 GEO. L.J. 1789, 1817–31 (2000) (describing the importance of power and norms).

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small numbers bargaining condition prevails. In circumstances where, both presently and prospectively, a large number of well-qualified, noncollusive bidders exist, competition will obtain and only fair returns will be realized. Where, however, such parity conditions break down, the self-policing benefits of competition are no longer assured and concern with opportunism is accordingly warranted.⁶⁷

Settlement negotiations in litigation take place under bilateral monopoly conditions.⁶⁸ There is no market for the plaintiff's legal claim. Either the defendant will buy it or it will go unsold.⁶⁹ Although going to court is commonly referred to as the litigants' best "alternative,"⁷⁰ it is not an alternative in the market or economic sense. The court serves merely as a valuation mechanism to price the litigants' transaction, not as an alternate buyer for the plaintiff's cause of action. Looking at disputes through this lens explains the presence of strategic behavior, and the use of mediation services, in litigation. If mediators assist parties by reducing the impact of strategic behavior and adverse selection, and if such problems are likely to be particularly exacerbated in bilateral monopoly conditions,⁷¹ it is not

⁶⁷ Oliver E. Williamson et al., *Understanding the Employment Relation: The Analysis of Idiosyncratic Exchange*, 6 BELL J. ECON. 250, 259 (1975); see also Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 233, 249 (1979) [hereinafter Williamson, *Transaction-Cost Economics*] ("Market alternatives are mainly what protect each party against opportunism by his opposite.").

⁶⁸ See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 68, 608 (5th ed. 1998) (describing lawsuits as bilateral monopoly).

⁶⁹ For an intriguing analysis suggesting that the strategic opportunism caused by the nature of disputes as bilateral monopolies might be eliminated by allowing the sale of litigation, see Ari Dobner, Comment, *Litigation for Sale*, 144 U. PA. L. REV. 1529, 1537–38 (1996) ("The ability to sell claims destroys this bilateral monopoly and cures the holdout problem.").

⁷⁰ See ROGER FISHER ET AL., *GETTING TO YES* 100 (2d ed. 1991) (defining the term "BATNA" or best alternative to a negotiated agreement).

⁷¹ I do not want to suggest that parties will *always* fail to reach agreement when bargaining in bilateral monopoly conditions, nor that such agreements will always be inefficient. In *The Problem of Social Cost*, Coase suggests that even parties in a bilateral monopoly will arrive at an efficient transaction. Ronald Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 8 (1960). The suggestion is merely implicit, however, arising from his use of several bilateral monopoly examples to illustrate his conclusion that as long as the market works, allocation of legal entitlements is a wash. But—and here I know that I am attempting to sidestep a hornet's nest—I tend to think that Coase does not solve the problem of bilateral monopoly as much as he assumes it away. Coase acknowledges the possibility of strategic behavior in a bilateral monopoly, but ultimately assumes that "such manoeuvres are preliminaries to an agreement and do not affect the long-run equilibrium position." *Id.* at 8. For critique of this assumption, see Donald H.

surprising that these services have arisen in the litigation context.⁷² Because parties in a bilateral monopoly situation like litigation are likely to experience bargaining failures, mediation and other mediator services have evolved to address such inefficiencies.

3. *Transactional Bargaining and Bilateral Monopoly*

This analysis seems to have taken us back to where we started. Dealmaking generally takes place in competitive markets: if I cannot do the deal with you, I can do it with someone else. This suggests that there should be little for a mediator to do in contract bargaining. Unlike in settlement negotiations, the market should mitigate adverse selection problems, eliminating this justification for mediator intervention.

This market argument is certainly powerful, and it suggests that the economic justification for mediators may be less applicable in transactions than in disputes, but does it completely eliminate the possibility that mediators could help contracting parties discover whether trade is possible or find Pareto-efficient agreements? Is it really accurate to describe transactional negotiations as fully collaborative information-sharing experiences devoid of strategic posturing?

I think not. To understand where this market argument overstates its case, one needs to look more closely at contract formation in complex deals. In this section, I argue that a complex deal often takes on bilateral monopoly characteristics at certain stages of the deal's life cycle. I contend that adverse

Regan, *The Problem of Social Cost Revisited*, 15 J.L. & ECON. 427, 428 (1972); see generally Stewart E. Sterk, *Neighbors in American Land Law*, 87 COLUM. L. REV. 55 (1987) (reviewing the literature and criticizing Coase's assumptions). And although some continue to argue that negotiators will arrive at efficient agreements even in bilateral monopoly conditions, "more have argued that bilateral monopoly markets are inherently inefficient and prone to produce much bargaining and failed transactions." Herbert Hovenkamp, *Rationality in Law & Economics*, 60 GEO. WASH. L. REV. 293, 307 (1992) (reviewing literature). *But see* Charles W.L. Hill, *Cooperation, Opportunism, and the Invisible Hand: Implications for Transaction Cost Theory*, 15 ACAD. OF MGMT. REV. 500, 509 (1990) (arguing that opportunistic players will be forced out of the market over time); Richard D. Friedman, *Antitrust Analysis and Bilateral Monopoly*, 1986 WIS. L. REV. 873, 900-11 (arguing that bilateral monopolists will arrive at Pareto optimal agreements regarding quantity and price).

⁷² Transaction cost economics predicts that bilateral monopoly markets will adopt governance structures to regulate bargaining. This is one explanation for the evolution of adjudication and the court system. See Williamson, *Transaction-Cost Economics*, *supra* note 67, at 250-52; see also Kenneth J. Arrow, *Information and Economic Behavior*, in 4 THE ECONOMICS OF INFORMATION: COLLECTED PAPERS OF KENNETH J. ARROW 136, 148 (1984) (suggesting that "economic institutions may compensate [for adverse selection] by introducing nonmarket informational devices").

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selection problems may arise at any of four stages of a transaction—matching, pricing, closing, and renegotiation—but that they are likely to increase in intensity as a transaction progresses towards closing and renegotiation. In particular, I argue that closing stage negotiations over the legal terms and conditions of a transaction—the stage at which transactional lawyers are likely to be most involved—take on quasi-bilateral monopoly conditions, making mediator intervention particularly attractive in that stage.

Before using these stages to explore the roles that mediators can play in deals, a caveat is in order. These stages are not perfectly distinct, and their importance differs deal-to-deal and context-to-context. I do not pretend—nor need to claim for the argument here—that all deals progress uniformly through these phases. They do not. Negotiations in a residential real estate transaction may focus more on the pricing stage and less on closing, because convention and statute may limit the need for tailoring legal language to shift risk during the closing stage. Conversely, a merger negotiation may involve extended closing negotiations even though pricing occurred relatively quickly. The utility of this breakdown derives from its ability to illuminate what *is* common among most transactions: that transactional negotiations tend to move through similar issues in sequence; that agents play different roles in deals during these different phases; and, ultimately, that opportunities for mediator intervention may vary over the life cycle of a transaction.

a. *Matching*

In the matching stage of a deal, a buyer and seller must find each other. The transaction costs in question are search costs: the costs associated with identifying a suitable trading partner. Although contracting parties often find each other on their own, in markets with high search costs, various agents—sometimes called “finders”—may serve as matchmakers. Given the availability of such agents, for our purposes the question is whether a mediator can add value in matching.

Finders are active in the matching process in many transactional contexts, including residential and commercial real estate, small business transactions, mergers and acquisitions, securities offerings, and other types of deals. Headhunters, for example, trade on information in employment markets. In residential real estate, real estate agents match buyers and sellers with the aid of the multiple listing service (MLS). The MLS reduces search costs by allowing agents to conduct multi-variable property searches tailored to a buyer’s preferences. In commercial real estate, the absence of an MLS-type system necessitates dedicated finders to bring parties together. Similarly, in mergers and acquisitions, investment banks, M&A departments

of commercial banks, and merger consultants often introduce buyers and sellers.⁷³ Lawyers also sometimes play this role.⁷⁴

Would a mediator offer advantages over such a finder? In most cases, probably not. At this stage there are unlikely to be difficult adverse selection problems for a mediator to resolve. The matching agent adds value by investing in information about the market—knowing where to find suitable homes or businesses for sale, for example. To make use of this service, neither buyer nor seller need reveal sensitive information or fear that information asymmetries will lead to strategic exploitation. Given the likelihood of large numbers competition, there is little incentive to behave strategically. A buyer who wants to purchase a home has no reason to pretend otherwise, although she may want to hide *how much* she desires the property. But in general matching only requires disclosing the basic interest to purchase, not its extent (or, put differently, not one's reservation price). As a result, at this stage there are few adverse selection problems for a mediator to help parties overcome. Agents can fill the need for matchmakers.

There *are*, however, some circumstances in which a mediator might add value in the matching stage. Some transactions require that parties share confidential information to determine whether a match is possible. For example, two pharmaceutical companies considering a joint venture may need to exchange formulas, products, and strategic plans to see if a deal makes sense. The parties may fear disclosing too much, however, because if no deal is consummated they may have provided valuable information to a competitor. Although parties can protect against the misuse of such information through both contract and tort,⁷⁵ such controls may be imperfect. A negotiating party may fear that *ex post* it will be difficult to enforce a confidentiality provision quickly and completely enough to prevent the party's information from becoming public.

Simultaneously, the other party may fear exposing itself to litigation if it begins negotiations with a counterpart claiming to have private information.

⁷³ See Alan K. Wells, *Acquisition Intermediaries: Purveyors of Opportunity*, in DIRECTORY OF M&A INTERMEDIARIES 13, 14 (2001) ("The act of introducing or causing the introduction of a buyer and seller is probably the most important function the intermediary performs.").

⁷⁴ See Lisa Bernstein, *The Silicon Valley Lawyer as Transaction Cost Engineer?*, 74 OR. L. REV. 239, 247–48 (1995) (discussing lawyers playing a matching role in venture capital deals).

⁷⁵ Although parties can contract to protect confidences, many may fail to do so. See G. Richard Shell, *Opportunism and Trust in the Negotiation of Commercial Contracts: Toward a New Cause of Action*, 44 VAND. L. REV. 221, 236 (1991). In tort, parties can turn to the tort for misappropriation of trade secrets, which has been applied to the precontractual bargaining process. See *id.* at 237–38.

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Some markets, for example, have seen opportunistic inventors flooding manufacturers with vague descriptions of new gadgets for the sole purpose of getting a foot in the door on a future suit for misappropriation of trade secrets.⁷⁶ In such circumstances, a manufacturer may legitimately fear talking with potential partners, unsure of whether such negotiations will expose the manufacturer to liability.

A mediator could help parties in these circumstances.⁷⁷ By comparing information, the mediator could determine whether a deal is possible or whether further discussions would be worthwhile. As long as the parties trust that the mediator can and will keep such information confidential,⁷⁸ and so long as the mediator is sufficiently expert to render an opinion on the viability of a deal, the parties might use a mediator to overcome these matching stage strategic difficulties.

b. Pricing

After finding each other, the parties must set a basic deal price. This often takes place through direct negotiation by the principals. Can a mediator add value in pricing?

Some transactional contexts are true bilateral monopolies. In such deals, pricing may become strategic, as each side tries to conceal its reservation price to negotiate for a better deal. As in litigation, mediator services have arisen to help transacting parties deal with strategic problems in some bilateral monopoly bargaining. Collective bargaining is a common example of bilateral monopoly contracting—the presence of a union serves to limit the

⁷⁶ See *id.* at 238–39.

⁷⁷ I can think of one other circumstance in which a mediator might have advantages over an agent in the matching process: dating. There an available single might fear even initiating “negotiations” with a blind date and thus might seek help in screening potential dates for suitability. The single might not trust that a partisan agent, such as a friend, will be able accurately to assess suitability, however, and may also distrust an agent and fear that the agent will engage in over-matching (*e.g.*, the proverbial parent who tries to fix the single up with every available date in town). As a result, the single might find greater benefit in a mediator dating service than in a partisan agent. The mediator service might be able to screen potential candidates, always threatening to remove deceptive candidates from the mediator’s pool of singles. In this way the mediator might uncover more accurate information than a partisan agent could on behalf of a single. In other words, the mediator could create value by verifying type or identity. This would occur only in heterogeneous markets in which party identity matters. In most markets with large numbers competition and market homogeneity, however, a mediator is unlikely to have much advantage over an agent.

⁷⁸ See *infra* Part IV for discussion of the confidentiality and privilege problems in the transactional context.

employer's market alternatives—and mediators often assist in this domain.⁷⁹ Similarly, the sale of an Internet domain name is a modern bilateral monopoly transaction prone to strategic bargaining. Again, mediation and arbitration are used to overcome these strategic problems.⁸⁰

Although to date we have had no evidence as such—an empirical gap that I begin to remedy in Part IV—one would certainly hypothesize that we should expect to see mediators assisting in any true bilateral monopoly transaction. For example, as one family member tries to sell its shares in the family's privately-held company to a sibling, the negotiations may deadlock quickly over the appropriate price.⁸¹ Likewise, a landowner of a landlocked parcel may find it difficult to bargain with his neighbor for an easement granting access to the landowner's property.⁸² The presence of only one seller and only one buyer may tempt either party to hold out in order to extract concessions from the other. Similarly, some intellectual property negotiations present a bilateral monopoly bargaining problem. For example, negotiations between a patentee of a partial genomic sequence and the patentee of the complementary sequence may become adversarial. The patents themselves may provide the transacting parties with all relevant information about their respective inventions, essentially eliminating information asymmetries about everything other than reservation price. Even with full information and obvious gains from trade, however, the parties do not always reach a deal. As Rochelle Dreyfuss explains, “[o]ften there is no agreement at all, or the agreement is much delayed. In the case of patents, it is sometimes so far into the patent term that significant value is dissipated.”⁸³ In other words, because they are tempted to hold out for greater concessions,

⁷⁹ The Department of Labor estimates that 96% of collective bargaining agreements include a dispute resolution clause. See U.S. DEP'T. OF LABOR, CHARACTERISTICS OF MAJOR COLLECTIVE BARGAINING AGREEMENTS 112 (1981).

⁸⁰ See Gideon Parchomovsky, *On Trademarks, Domain Names, and Internal Auctions*, 2001U. ILL. L. REV. 211, 215–16 (discussing domain name disputes as bilateral monopoly, describing current ADR procedures in this context, and proposing auction mechanism to produce efficient outcomes).

⁸¹ See Howard Raiffa, *The Neutral Analyst: Helping Parties to Reach Better Solutions*, in NEGOTIATION: STRATEGIES FOR MUTUAL GAIN 14, 19 (Lavinia Hall ed., 1993) (describing this example and explaining how Raiffa served as a mediator to aid the transacting parties).

⁸² See Sterk, *supra* note 71, at 76–77 (discussing this problem).

⁸³ Rochelle Cooper Dreyfuss, *Games Economists Play*, 53 VAND. L. REV. 1821, 1828 (2000); see also Robert P. Merges, *Of Property Rules, Coase, and Intellectual Property*, 94 COLUM. L. REV. 2655, 2659 (1994) (noting that valuation problems permit strategic bargaining).

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the parties either fail to discover that gains from trade are possible, or they may reach a Pareto-suboptimal deal.⁸⁴

In addition to such bilateral monopolies, one would expect to see strategic bargaining—and the potential for mediator intervention—in pricing transactions in any sort of thin market. The sale of an idiosyncratic good may become strategic if there is a limited pool of potential buyers. For example, a large pharmaceutical company that manufactures a unique product may need the services of a specific biotech firm to improve the drug's capabilities. With only one potential service provider and limited demand for the biotech's capabilities, the parties may face quasi-bilateral monopoly conditions. Some employment contract negotiations—such as for sports stars, entertainers, or even a CEO or manager with specialized experience—may take on bilateral-monopoly conditions if few firms have demand for the potential employee's special skills and, simultaneously, few skilled persons are available in the market. Finally, transactions with a federal, state or local government can also take on bilateral monopoly conditions. For example, the owner of a shopping mall complex may need to negotiate terms and conditions with a city government to revitalize the area. Each side is locked into doing a deal with the other.

That a mediator could assist in pricing deals in thin markets, however, does not mean that a mediator can *always* add value in pricing by overcoming asymmetric information about reservation price. As discussed above, theoretically parties should not price strategically in competitive markets (although some will inevitably try). Instead, the market will price transactions efficiently without assistance. Whether a consumer is buying new shoes at a retail shop or two CEOs are pricing a merger or the sale of a corporate division, the presence of market alternatives *should* dampen strategic behavior in pricing a deal. As a *general* hypothesis, we should not expect to see severe posturing about reservation price in well-oiled markets. Thus, one of the central justifications for using mediators in litigation—to

⁸⁴ Various doctrines mitigate the effects of such conditions. Property law, for example, permits a landlocked owner to force an easement by necessity on a stubborn neighbor, essentially allocating the property right to the higher-value party to avoid the social costs of strategic deadlock. *See* Sterk, *supra* note 71, at 76–78 (analyzing this doctrine as a solution to bilateral monopoly problems). Per Williamson's insight that institutional structures will be needed in bilateral monopoly situations, the easement by necessity doctrine makes use of the court system to price a transaction that might otherwise fail to take place. Intellectual property doctrine reaches the same result with compulsory licensing rules. The compulsory licensing rules break the potential deadlock by permitting the subsequent innovator to force a transaction. *See* Steven Shavell & Tanguy van Ypersele, Rewards Versus Intellectual Property Rights 23 n.34 (1998) (unpublished manuscript, *available at* http://www.law.harvard.edu/programs/olin_center/papers/pdf/246.pdf) (last visited Jan. 27, 2004).

overcome information asymmetries and their attendant adverse selection problems—translates only partially to the transactional arena. If faced with bilateral monopoly conditions, a mediator may add value in pricing. Otherwise, the parties can price directly or through agents.

c. Closing

This analysis demonstrates that mediators could play a role, albeit somewhat limited, in matching and pricing transactions. Certain transactions are essentially just disputes in sheep's clothing: contracts are negotiated under the same conditions that make disputes so difficult to settle. This section argues that the closing stage legal negotiations of *many* deals face such conditions as well, making mediator intervention more valuable in this period of a complex transaction.

Negotiations during the closing stage focus on the contract's terms and conditions. In a merger or acquisition, for example, a preliminary price has likely already been set. The parties now attempt to confirm the quality of the assets to be transferred. The buyer may conduct due diligence and the parties bargain over inspection contingencies and discovered information about asset value. The buyer may try to use such contingencies to exit the deal, sometimes for strategic or economic reasons, or the parties may re-negotiate the closing price to reflect new information.

In complex transactions, lawyers, accountants, bankers, and other agents are generally brought in to assist in the closing stage.⁸⁵ Lawyers in particular are needed to draft legal language for an acquisition agreement or other contract. As the closing stage progresses, due diligence may not eliminate all uncertainties about the company or assets in question. Lawyers will therefore bargain over contract language to shift the risks associated with these remaining uncertainties.

One might expect these legal negotiations during closing to be fairly collaborative. As Ronald Gilson has explained, at least in theory, the parties to a transaction have good reason to share information openly.⁸⁶ In an

⁸⁵ In the merger context, brokers are very common. One study of mergers conducted between January 1995 and June 2000 found that of 4,845 completed deals, only 790 (or 16%) were conducted in-house without advisors. See William C. Hunter & Julapa Jagtiani, *Merger Advisory Fees and Advisors' Effort*, in EMERGING ISSUES, at 5 (Fed. Res. Bank of Chi., Emerging Issue Series 2000), available at <http://www.chicagofed.org/publications/publicpolicystudies/emergingissues/pdf/S&R-2000-11R.pdf> (last visited Jan. 27, 2004).

⁸⁶ See Gilson, *supra* note 5, at 270 (“There is . . . an incentive for the parties to cooperate both to reduce informational asymmetries between them and to reduce the costs of acquiring information . . .”).

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acquisition, for example, the target has little incentive to withhold information from the acquirer about the condition of the target company. If it does so, the acquirer will likely assume that the target's information is problematic for the target, and thus the acquirer will either exit or alter the transaction price if the information cannot be acquired elsewhere.⁸⁷ The target, therefore, wants to cooperate in educating the acquirer. The question is how to do so at the least cost, because the target knows that transaction costs incurred during the negotiations will reduce the surplus available for division between the parties.

If accurate, this description suggests that private incentives should already lead transacting parties to disclose information freely—obviating the need for a transactional mediator during closing. But Gilson acknowledges that his description of information exchange as an open and cooperative venture is at odds with the reality that business lawyers often do *not* cooperate in exchanging information. As he states, “[w]hat remains puzzling . . . is the apparent failure by both business lawyers and clients to recognize that the negotiation of representations and warranties . . . presents the occasion for cooperative rather than distributive bargaining.”⁸⁸ Myriad disagreements arise during transactional legal negotiations—about whether obligations in a preliminary agreement have been met, whether certain contingency-triggering events have occurred, or the allocation of risks regarding latent defects—and often lawyers bargain hard about them.

Gilson's puzzle is at least partially solved, however, if we remove the assumption that closing stage negotiations over terms and conditions take place under competitive market conditions with robust exit options. To the extent that a deal has taken on quasi-bilateral monopoly conditions by the time lawyers are called in—or, put differently, to the extent that those involved in closing stage negotiations feel bound to do the deal—the opportunity for strategic posturing arises.

This may occur for one of several reasons. First, as negotiations progress, the parties bind themselves through increasingly restrictive contractual commitments. A letter of intent, for example, may contain a no-shop

⁸⁷ Similarly, Shavell and others have argued that litigants have good reasons to share information with each other. See Steven Shavell, *Sharing of Information Prior to Settlement or Litigation*, 20 RAND J. ECON. 183, 184 (1989). To the extent that a party has private information that bears on case value, failure to disclose that information readily will signal that the information accrues to the benefit of the other side. Nondisclosure thus merely creates incentives for the other side to compel the information through discovery. See Bruce L. Hay, *Effort, Information, Settlement, Trial*, 24 J. LEGAL STUD. 29, 33 (1995) (explaining that a party “can infer from the [other’s] silence that he should demand the information”).

⁸⁸ Gilson, *supra* note 5, at 272.

agreement restricting the seller's ability to find alternate buyers, but it will likely contain various ways that one or both parties could exit the deal. During the closing stage, however, the parties restrict these exit options. As exit options disappear through tightening of contractual commitments, neither party believes that they can exit, or at least exit without incurring significant costs.

In particular, transacting parties may fear that exit will give rise to litigation. Although contract doctrine traditionally limited any cause of action for pre-acceptance reliance, courts have infamously loosened these constraints over time.⁸⁹ Transacting parties may thus be uncertain about whether their preliminary commitments to each other have given rise to liability. More important, perhaps, parties will often be uncertain about the risk of liability because of the inherent possibility that a court will misunderstand their contractual arrangements and find binding obligations when none were intended.

Second, what may have been a competitive market in the pricing stage—when one or both parties could have looked to the market for an alternate trading partner—may take on quasi-bilateral monopoly conditions if a seller is pessimistic about the likelihood of finding more than one buyer (or vice versa), or if sufficiently high search and switching costs prevent going to an alternate buyer after negotiations have begun with the first buyer found. Some models suggest that even relatively small switching costs can prevent changing trading partners.⁹⁰ As a recent economic analysis noted, the presence of switching costs may “make a large finite market essentially identical to bilateral monopoly.”⁹¹ And as one practitioner has explained, “[t]he parties, particularly if they are part of large organizations, become emotionally and, more importantly, bureaucratically committed to getting the deal done. After announcing the execution of the letter of intent, neither party wants to be the one to walk without a very good reason.”⁹²

Third, given that the principals may have already made public announcements to the market about the transaction—or may have posted

⁸⁹ Compare *James Baird Co. v. Gimbel Bros., Inc.*, 64 F.2d 344 (2d Cir. 1933) (finding no pre-acceptance reliance) with *Drennan v. Star Paving Co.*, 333 P.2d 757 (Cal. 1958) (permitting cause of action for pre-acceptance reliance).

⁹⁰ For a formal analysis of this problem, see Gianni de Fraja & Abhinay Muthoo, *Equilibrium Partner Switching in a Bargaining Model with Asymmetric Information*, 41 INT'L. ECON. REV. 849, 860 (2000) (presenting formal analysis of switching cost problem). If a seller is sufficiently pessimistic, “the outside option is useless,” transforming the market into what these authors call a “natural bilateral monopoly.” *Id.*

⁹¹ *Id.* at 861.

⁹² See STANLEY FOSTER REED & ALEXANDRA REED LAJOUX, *THE ART OF M&A: A MERGER ACQUISITION BUYOUT GUIDE* 448 (3d ed. 1999).

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some other sort of bond making exit expensive⁹³—the lawyers, accountants, and other agents trying to close the deal may not adequately consider “going to the market” rather than reaching agreement. Such announcements may have both intangible psychological effects—committing one or both sides (and their constituents and stakeholders) to the deal—and more tangible effects. An M&A announcement, for example, will already have inflated (or deflated) stock prices by the time closing stage legal negotiations take place. Those involved in this stage of the deal may thus be reluctant to consider exit.

Fourth, as mentioned above, lawyers and other agents are often the primary negotiators in the closing stage of a deal. A certain type of agency costs may thus make it more difficult for a lawyer to choose to exit. If the principals are largely absent during the legal negotiations in closing, the lawyers may not have the authority to threaten to “walk.” The common separation between “legal issues” and “business issues” in a deal may work to the lawyer’s disadvantage—the lawyer may not really know the market situation and whether there is a viable alternative to doing the deal with this particular counterpart.⁹⁴ This may lead lawyers negotiating terms and conditions to behave as if there is no viable exit alternative, meaning that they bargain in the absence of a market to constrain strategic behavior.

Fifth, the “goods” to be traded by lawyers during the closing stage are often idiosyncratic. Lawyers in a merger or acquisition may bargain over the allocation of risks regarding future lawsuits against a target company for environmental contamination or personal injury caused by one of the company’s products. However, there may be no market for these risks—and thus no established market price.⁹⁵ As a result, in designing contract mechanisms to trade on these risks, the lawyers may engage in hard bargaining tactics, just as in litigation.

⁹³ By posting a bond at the start of the transaction—such as a deposit in a residential real estate transaction or an announcement to the public in a corporate transaction (which can serve as a reputational bond)—the parties shift the negotiation towards bilateral monopoly conditions.

⁹⁴ This can manifest in another way as well. The commitments made during the pricing stage can make the closing stage negotiation over representations and warranties a distributive problem because concessions on legal language often are *not* compensated for with changes to the deal price. See Edward A. Bernstein, *Law & Economics and the Structure of Value Adding Contracts: A Contract Lawyer’s View of the Law & Economics Literature*, 74 OR. L. REV. 189, 195 (1995) (agreeing with Gilson that many representations and warranties serve to reduce transaction costs, but noting the lawyers work in the shadow of a fixed deal price).

⁹⁵ In some cases insurance may be available to cover the risks, but often the risks may be so vague or amorphous that the lawyers may not be able to find good market information on how to price the risks.

These various explanations for strategic behavior in the closing stage of a deal help to explain Gilson's observation that, in practice, transactional negotiations over representations and warranties are often adversarial. Although a given transaction may occur in an active market with alternate buyers or sellers, certain *periods* of the negotiation may resemble bilateral monopoly conditions. Both buyer and seller are—or feel—bound together. As negotiations progress through the closing stage, they may thus become increasingly strategic and hostile.⁹⁶

I do not want to overstate this possibility. In many transactions, both sides continue to seek or consider alternate trading partners, and the market may thus constrain opportunism.⁹⁷ In addition, norms⁹⁸ and reputations⁹⁹ may constrain strategic behavior during closing negotiations. Nevertheless, this analysis suggests that mediator intervention might be helpful during the closing stage, particularly vis-à-vis the drafting of a deal's legal documentation. This, in turn, suggests a special role for lawyer-mediators in transactions, as they may be best able to assist parties with the legal aspects of closing.

A lawyer-mediator might prevent the parties' lawyers from blowing up the deal unnecessarily, and, perhaps more importantly, from reaching an inefficient set of contract terms. As lawyers and clients allocate legal risks

⁹⁶ This seems to be in accord with the realities of transactional practice. Lawyers bemoan "eleventh hour" closing tactics, common at the end of the deal.

⁹⁷ As James Freund has noted,

[i]n deal-making, if negotiations prove unsuccessful, one or both parties can simply walk away from the table As a result, unless your leverage happens to be awesome, you can't take too unreasonable a position on a deal you want to see happen—and you can't 'stick' with impunity on anything less than a genuine deal-breaker.

JAMES C. FREUND, *THE NEUTRAL NEGOTIATOR: WHY AND HOW MEDIATION CAN WORK TO RESOLVE DOLLAR DISPUTES* 7 (1994).

⁹⁸ See, e.g., Lisa Bernstein, *Formalism in Commercial Law: The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study*, 66 U. CHI. L. REV. 710, 717 (1999) (arguing that weakform norms related to cooperation exist in certain industries and exploring the role of norms in contracting). For a recent empirical examination of the power of relational norms in negotiation, see Jared R. Curhan et al., *The O. Henry Effect: Relational Norms and Negotiation* (2002) (working paper, on file with author) (describing two studies on the role of relational norms and concluding that "in real world contexts, negotiators occasionally forfeit instrumental outcomes, consciously or unconsciously, in deference to the pursuit of relational goals and/or the adherence to relational norms").

⁹⁹ Reputation is very important in contracting. See, e.g., Robert E. Scott, *Conflict and Cooperation in Long-Term Contracts*, 75 CAL. L. REV. 2005, 2032 (1987) ("Contracting parties have an incentive . . . to develop a reputation that both encourages mutually beneficial cooperation and deters exploitation.").

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and opportunities, possibilities for gains from trade arise because of differences in the parties' preferences and relative valuations. Although the bargaining about a single contract term may be largely distributive—I want a more restrictive allocation of responsibility for an environmental clean up, you want a more expansive term—contracting attorneys can generally create value by trading between terms.¹⁰⁰ For example, if a contract contains ten legal provisions (A, B, . . . J), parties X and Y will value those terms differently. If X finds term A extremely important and Y term B, they can create joint gains by allocating the risk in term A as X prefers and the risk in term B as Y prefers. And so on.

If transacting lawyers shared information openly, they would find such trades (at least to the extent that doing so was justified in light of the transaction costs incurred through the additional bargaining that would be required). As a result, one would expect to see highly tailored contractual provisions in complex deals—tailored terms would reflect these tailored trades.

Empirical analysis of contracts, however, shows that parties often do *not* trade risk in complex—yet value-creating—ways. Instead, in many domains contracts are simpler than one might expect.¹⁰¹ Various explanations have been offered for this simplicity, including behavioral explanations¹⁰² and the network effects theory.¹⁰³ Another, less explored, explanation is that the

¹⁰⁰ See MNOOKIN ET AL., *supra* note 4, at 145.

¹⁰¹ See Karen Eggleston et al., *The Design and Interpretation of Contracts: Why Complexity Matters*, 95 NW. U. L. REV. 91, 94–97 (2000) (reviewing various examples); *id.* at 104 (“The puzzle that motivates this paper is that a large and sophisticated body of work, primarily produced by economists, implies that contracts should be complex, whereas in fact they are generally simple.”); see also JAMES C. FREUND, ANATOMY OF A MERGER: STRATEGIES AND TECHNIQUES FOR NEGOTIATING CORPORATE ACQUISITIONS 140 (1975) (describing that most agreements cover similar ground and even share similar language).

¹⁰² Several scholars have pointed to status quo bias as a possible cause of contract standardization. The status quo bias is a psychological tendency to prefer the present state of the world and to resist either buying something that you do not own or selling something that is yours. See Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 74 WASH. U. L.Q. 347, 359 (1996) (citing William F. Samuelson & Richard Zeckhauser, *Status Quo Bias in Decision Making*, 1 J. RISK & UNCERTAINTY 7 (1988)); Russell Korobkin, *Inertia and Preference in Contract Negotiation: The Psychological Power of Default Rules and Form Terms*, 51 VAND. L. REV. 1583, 1584 (1998).

¹⁰³ See, e.g., Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (Or “The Economics of Boilerplate”)*, 83 VA. L. REV. 713 (1997); see also Mark A. Lemley & David McGowan, *Legal Implications of Network Economic Effects*, 86 CAL. L. REV. 479 (1998).

threat of strategic behavior prevents parties from complex contracting.¹⁰⁴ To create a tailored term requires disclosing information about one's interests and preferences. This, again, permits exploitation. In the absence of trust, parties may resort to a standard term to minimize this risk.

A mediator might help the parties to overcome these strategic difficulties, thereby permitting more complex contracting. Again, a mediator can solicit and compare information from each side, potentially finding value-creating trades. The mediator might test the viability of various packages of trades of legal terms, asking each side in confidence which of several sets of terms the party would accept, but not revealing the origin of the various packages. In this way, the mediator can surmount the adverse selection problems that might otherwise prevent tailoring contract language during the deal's closing stage.

d. *Renegotiation (and Planning for Renegotiation During Closing)*

Many deals do not end at closing. Instead, in complex transactions the parties may revisit their initial agreement and renegotiate key terms that were either originally left open or have become inefficient or outdated. Here I briefly consider the use of mediators to manage disputes that arise during the renegotiation phase, but then focus primarily on how transactional mediators can help parties *during closing* to incorporate legal terms *ex ante* that constrain *ex post* opportunism.

In an ideal world, renegotiation seems to weaken the economic justifications for using a transactional mediator. If the parties discover contract inefficiencies after closing, they can simply renegotiate those provisions of the agreement. Thus, significant Pareto-optimizing improvements will ultimately be found, even if overlooked in the parties' original interaction.

This ideal is certainly realized in some circumstances. Parties can use renegotiation to adjust deal terms in the face of new information, and may take this opportunity to make their transaction more efficient. Renegotiation will not always be easy, however. Sometimes parties will see renegotiation as an occasion to extract additional concessions, not as a collaborative chance to improve efficiency. In particular, as the relational contracting literature has long explored,¹⁰⁵ renegotiation can be difficult if the parties have made relationship-specific investments that lock them into a bilateral monopoly.¹⁰⁶

¹⁰⁴ See Eggleston et al., *supra* note 101, at 109 ("Simplicity . . . is the result of strategic concealment of information.").

¹⁰⁵ See *supra* note 12.

¹⁰⁶ See Williamson, *Transaction-Cost Economics*, *supra* note 67, at 241 (describing

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For example, if an employee has invested in special knowledge that is valuable only to his employer (e.g., learning internal systems or technologies), and his employer has similarly invested in the employee, when it comes time to renegotiate salary the parties may be reluctant to look elsewhere for an alternate trading partner.¹⁰⁷ Because the market does not serve as a constraint on their bargaining—if the employer offers too little it will be difficult for the employee credibly to threaten to seek employment elsewhere, and vice versa—one or both parties may behave opportunistically during renegotiation.¹⁰⁸ As Williamson explains:

[J]oined as they are in an idiosyncratic condition of bilateral monopoly, both buyer and seller are strategically situated to bargain over the disposition of any incremental gain whenever a proposal to adapt is made by the other party. Although both have a long-term interest in effecting adaptations of a joint profit-maximizing kind, each also has an interest in appropriating as much of the gains as he can on each occasion to adapt. Efficient adaptations which would otherwise be made thus result in costly haggling or even go unmentioned¹⁰⁹

In short, disputes that arise during renegotiation can be difficult for parties to resolve because of the temptation to extract opportunistic gains as soon as both parties are locked into a long-term relationship by relationship-specific investments.

Mediators—particularly arbitrators—are now commonly used to help control post-contractual opportunism¹¹⁰ in various contexts, including long-term contracts with the government¹¹¹ and commercial construction

consequences of this transformation); see also Avery Katz, *When Should an Offer Stick? The Economics of Promissory Estoppel in Preliminary Negotiations*, 105 YALE L.J. 1249, 1280 (1996) (discussing the holdup problems that occur during contract modification or renegotiation).

¹⁰⁷ See, e.g., John J. Donohue III, *Diverting the Coasean River: Incentive Schemes to Reduce Unemployment Spells*, 99 YALE L.J. 549, 592 (1989) (describing how an employment relationship may become a bilateral monopoly once the employment agreement is signed).

¹⁰⁸ See Scott E. Masten et al., *The Costs of Organization*, 7 J.L. ECON. & ORG. 1, 6 (1991) (arguing that such situations are characterized by increased “resources expended attempting to negotiate a favorable distribution of the gains from trade”).

¹⁰⁹ Williamson, *Transaction-Cost Economics*, supra note 67, at 242.

¹¹⁰ Williamson called this type of intervention “trilateral governance.” *Id.* at 249. Ian Macneil similarly considered the use of arbitrators in long-term contracts. See Ian R. Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law*, 72 NW. U. L. REV. 854, 867 (1978).

¹¹¹ See, e.g., Keith J. Crocker & Kenneth J. Reynolds, *The Efficiency of Incomplete Contracts: An Empirical Analysis of Air Force Engine Procurement*, 24 RAND J. ECON.

contracts.¹¹² Although this offers some support for my general argument that mediators can add value in transactions, I must draw a distinction between two uses of mediators in renegotiation. If parties merely hire a mediator to help them resolve a dispute over contractual terms rather than litigate that disagreement, this use of a mediator seems more akin to traditional mediator intervention in litigation than to the sorts of transactional interventions I am concerned with in this Article. If, however, parties use a mediator to help them discuss improvements on or extensions of their contract—extensions that essentially create a new deal rather than resolve a dispute about their old contract—this would be an example of transactional mediation as I conceive it. *Both* types of intervention are plausible, but there is no existing empirical evidence to suggest which type occurs most frequently when mediators currently intervene in renegotiation.

Rather than focus on the use of mediators to intervene during renegotiation, however, I am more concerned here with the ways in which a mediator can add value *pre-closing*. In addition to using mediators during the renegotiation stage to resolve disputes, parties may also try to mitigate post-contractual opportunism through tailored contract terms that create incentives to comply. A contract without such safeguards will impose greater costs on a party expecting to make transaction-specific investments, and that party will therefore set a higher price for the transaction. To the extent that contract terms can be used to constrain the threat of opportunism, it will increase the surplus available in the transaction. This aspect of transactional lawyering has been well-explored¹¹³ and documented.¹¹⁴

Parties, however, may not always avail themselves of such opportunism-constraining terms. First, by the time negotiating parties (or their lawyers) conclude their closing stage negotiations, they may not sufficiently trust each other to rely on contractual solutions to future moral hazard problems.

126 (1993) (discussing third-party systems to keep long-term government contracts functioning in the face of strategic behavior).

¹¹² Disagreements in commercial construction contracts are traditionally referred to the architect or project engineer for resolution. *See* Stipanowich, *The Multi-Door Contract*, *supra* note 12, at 358. In recent years this tradition has evolved, particularly in large projects. Standing panels of mediator engineers and experts are now sometimes employed to provide “real-time” dispute resolution as a construction project unfolds. *See id.* at 362–64.

¹¹³ *See, e.g.,* Gilson, *supra* note 5.

¹¹⁴ Empirical studies indicate that contract complexity increases with the threat of future opportunism (as measured by reputation for litigation, past litigious behavior, etc.). *See* Crocker & Reynolds, *supra* 111, at 145 (“A record of past opportunistic behavior or the potential for hold-up in a sole-source environment . . . increases the likelihood of ex post redistributive efforts with the attendant bargaining costs, and results in the use of more complete contracts [ex ante].”).

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Anecdotal evidence suggests that “earnouts,” for example, even if negotiated carefully, are often bought out from M&A deals just prior to closing.¹¹⁵ The parties know that the “earnout” provision’s legal constraints on future opportunism will be imperfect, and by the closing date the parties may no longer trust each other enough to overcome doubts about such opportunism. To the extent that using a mediator throughout a transaction can help the parties better maintain trust, the parties might be more inclined to rely on such potentially value-creating terms.

Second, even if the parties *do* trust each other, they may avoid discussing such opportunism-constraining terms for fear of destroying that trust. Edward Bernstein has described the problem of “attitudinal costs” in transactional bargaining.¹¹⁶ When a party suggests crafting tailored contract provisions that are obviously intended to minimize the threat of future opportunism by the other party, that other party may receive the suggestion badly. The receiving party may perceive the suggestion as a signal that future disagreements will have to be resolved through formal contracting rather than more informal, friendly means. This may cause mistrust or suspicion and lead the receiving party to become more guarded or adversarial. This, in turn:

[M]ay reduce the value of the transaction if it contemplates a continuing relationship or performance over time, such as a partnership, joint venture or construction contract. If negotiations are hostile, each party can expect a reduced probability of voluntary performance by the other who, if he has concluded that acting in the spirit of the transaction will not be reciprocated, will be more inclined to base his breach or perform decisions upon a comparison of legal sanctions against the benefit of breach.¹¹⁷

Bernstein has analogized this to the risk for a personal relationship created by suggesting the negotiation of a prenuptial agreement.¹¹⁸

Such attitudinal costs may prevent parties from adopting efficient contract terms. For example, parties may be unwilling to avail themselves explicitly of Oliver Williamson’s solution to moral hazard problems—the use

¹¹⁵ An earnout is a means of dealing with differences in expectations about future valuation of an asset. *See supra* note 7 and accompanying text (discussing earnouts); *see also* REED & LAJOUX, *supra* note 92, at 118–19 (discussing this problem).

¹¹⁶ *See* Bernstein, *supra* note 94, at 231 n.111. This is a familiar theme in contract. *See* Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 61 (1963) (noting that “[t]here is a hesitancy to speak of legal rights or to threaten to sue in . . . negotiations” when there will be an ongoing relationship); *see also* Eggleston et al., *supra* note 101, at 118–19 (citing sources).

¹¹⁷ Bernstein, *supra* note 94, at 231.

¹¹⁸ *See id.*

of hostages.¹¹⁹ As Williamson has explained, a hostage can dampen future opportunistic behavior if the hostage-taker derives little intrinsic benefit from the hostage (and is therefore unlikely to be opportunistic in *using* the hostage) but can impose significant pain on the hostage-giver by retaining the hostage.¹²⁰ Although hostage-taking may be efficient under some circumstances, parties may avoid them because “a request for the delivery of a hostage signals an absence of trust.”¹²¹

A mediator might add value in closing stage negotiations by facilitating discussion over such terms while minimizing the downside risk to the parties’ relationship. As discussed above,¹²² a mediator can add noise to the parties’ communications and therefore change the strategic implications of the signals sent. A mediator, for example, might disguise the origins of a proposal incorporating certain hostage-taking terms (or other terms designed to constrain future opportunism). Or a mediator might lay out several different packages of legal terms, some of which incorporate such constraints, and encourage the parties to contrast the packages and rank them in terms of how satisfied each package makes each party. By comparing the rankings, the mediator could discern which package of terms best served the parties’ needs. The mediator could then present that package as a Pareto-optimizing solution to the myriad problems dealt with by the contract, in effect shifting the parties’ attention away from the “attitudinal costs” Bernstein describes and towards the value-creating benefits of incorporating opportunism-constraining language.

The point, in short, is that mediators can do more to manage the strategic problems that arise during renegotiation than merely participating—pursuant to an ADR clause in the original closing documents—in a dispute resolution system that kicks in when renegotiation occurs. A mediator can assist parties during their *original* negotiation to facilitate efficient contractual solutions to future renegotiation problems. Again, a mediator may add value during the

¹¹⁹ This use of the term “hostage” refers to giving another party something of value as a bond guaranteeing that you will perform as you have promised. If you fail to perform, they keep the hostage.

¹²⁰ See Oliver E. Williamson, *Credible Commitments: Using Hostages to Support Exchange*, 73 AM. ECON. REV. 519, 522–26 (1983); see also David Charny, *Nonlegal Sanctions in Commercial Relationships*, 104 HARV. L. REV. 375, 406–07 (1990) (describing hostages).

¹²¹ Royce de R. Barondes, *The Business Lawyer as Terrorist Transaction Cost Engineer*, 69 FORDHAM L. REV. 31, 46 (2000). Transactional lawyers may attempt to create “hidden” or “latent” hostages by sneaking over-inclusive contractual language past opposing counsel. See *id.* at 47–48 (re-describing aggressive transactional lawyering as the attempt to create value by inserting hidden hostages into commercial contracts).

¹²² See *supra* note 40 and accompanying text.

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closing stage negotiations over legal terms, in this case by helping the parties to plan most efficiently for renegotiation.

C. Two Potential Problems

This Part has argued that mediators can add value in transactions by helping parties to overcome transaction costs that arise because of strategic behavior in bargaining. Throughout, I have assumed rational, self-interested parties. Before turning in Part III to a second set of behavioral justifications for transactional mediation, I must pause to consider two potential objections to my argument.

1. The Problem of “Gaming the Mediator”

The first potential problem is simple: just as parties try to manipulate each other, they will try to manipulate a mediator for their own advantage, thereby eliminating or greatly reducing the mediator’s ability to help parties overcome information asymmetries or adverse selection.

Mediators are not omnipotent. They cannot simply command full disclosure or expect that parties will drop strategic ambitions merely because a mediator is polite or friendly. Instead, we should expect that in some circumstances parties will try to maximize their own gains by misrepresenting information to the mediator. A plaintiff actually willing to settle her litigation for \$100,000 may swear to the mediator in a private caucus that she will not accept less than \$250,000. If the mediator in some way pressures the defendant to settle on those terms, the plaintiff will have turned the mediator into an unwitting ally. Similarly, in the various sorts of transactions discussed above—mergers and acquisitions, employment negotiations, real estate transactions—one can assume that some parties will choose to try to “game” the mediator.

How often parties attempt to deceive mediators is an empirical question that deserves study. To the extent that a mediator’s ability to add value by overcoming information asymmetries depends on the mediator receiving accurate information—about reservation price, interests, priorities, etc.—from the parties, widespread successful gaming of mediators obviously detracts from this argument for mediators. Although I cannot resolve this issue here, several things suggest that we should not be too hasty to dismiss the economic rationale that mediators can mitigate adverse selection.

First, the explosive growth of mediation in the litigation field suggests demand for mediator services. It is unlikely that such growth has all been supply-driven, irrational, or justified only by the psychological and emotional benefits mediators can provide. I think it more plausible to assume that

mediators are in fact helping parties to overcome the information asymmetries that make bargaining so difficult.

Second, Brown and Ayres explain that parties may disclose honestly if a mediator can threaten credibly to terminate the parties' negotiations should their offers—conveyed confidentially through the mediator—fail to overlap.¹²³ At a practical level, this threat is obviously a difficult one to enforce. In either litigation or a transaction, parties can easily participate in mediation, do their best to game the mediator (running the risk of deadlock), and then re-open negotiations face-to-face should the mediation fail to produce a viable agreement.

At the same time, Brown and Ayres' suggestion may not be entirely misplaced. To the extent that parties feel that they must eventually reach agreement (because they bargain under bilateral monopoly or quasi-bilateral monopoly conditions), their desire to overcome their differences and get the deal done may lead them to be open with a mediator. Negotiating parties often discover that holding out for more doesn't always work. If both sides play the same game, it may result in delay, deadlock, or escalation rather than strategic advantage. At some point, parties may decide that the time has come to see whether a deal is possible, essentially self-imposing the deadline that Brown and Ayres suggest a mediator should threaten. If such parties are willing to turn to a mediator for assistance, they may be willing to reveal information honestly to that mediator. This also bolsters my argument that mediators may add value primarily during closing stage negotiations over legal terms and conditions. As a deal's closing date approaches, lawyers and their clients may become increasingly willing to reveal information to a mediator in hopes that the mediator can help them overcome remaining disagreements.

Third, in some circumstances self-interest will temper dishonesty. If transacting parties made use of Raiffa's "contract embellishment" procedure, for example, and hired a mediator to find Pareto-optimizing trades that would make one or both better off, there would be little incentive to lie to that mediator. To some extent, the critique that parties will game mediators rests on the assumption that mediators serve primarily to compare parties' reservation prices. If parties seek mediator assistance in finding value-creating trades, however, the critique may have less force.

Finally, a mediator does not need *perfect* information to add value. Even if a mediator learns only a fraction of the truth, the mediator may be able to prevent unnecessary deadlock, or help the parties to find value-creating terms, if it is a fraction more information than the parties would otherwise exchange. Thus, although parties may try to game a mediator, if the mediator

¹²³ See *supra* note 38 and accompanying text.

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is sufficiently skilled to glean *any* useful information from such parties the mediator may be able to do her job.

In short, although I certainly acknowledge the practical difficulties with the economic argument for transactional mediators, I believe that mediators are sometimes able to overcome information asymmetries.

2. The Problem of Self-Interested Transactional Mediators

Just as mediators are not omnipotent, neither are they perfect. Introducing a mediator into a transaction adds a new set of problems: a mediator may act on her own interests rather than the parties'. The problem of disloyal mediators is intriguing but has rarely been examined. What fee structure is optimal to dampen self-interested behavior by a mediator or arbitrator, for example? Can a mediator accept a percentage of a transactional agreement or a litigated settlement and remain neutral? Is a flat fee more optimal than hourly billing? Although these questions are beyond the scope of this Article,¹²⁴ I must respond to the concern that introducing a mediator in transactions will do more harm than good because of the possibility of disloyalty.

To sidestep the problem somewhat, I have assumed in this Article that a transactional mediator will work on a flat or hourly fee. This reduces the incentive problems that would naturally arise if such a mediator could take a percentage of the transaction price. Even with a flat or hourly incentive structure, however, there may be an incentive problem. An hourly fee obviously creates a marginal incentive to prolong the negotiations, whereas a flat fee tempts a mediator to shirk in order to close the deal quickly.

These incentive problems are present vis-à-vis mediators in litigation as well. In transactions, however, parties may think that these incentive issues pale in comparison to the more fundamental problem that a mediator might be driven to close deals in order to build a reputation based on her success rate in closing deals.¹²⁵ That success rate provides a salient and tangible measure of the mediator's abilities. As businesspeople and their lawyers search for mediators to help with contract formation, they could easily compare mediators based on their history of bringing deals to fruition.

The problem, of course, is that if a mediator becomes driven to close deals, then she loses her impartiality and objectivity. Not all deals should

¹²⁴ For a discussion of fee structures in dispute mediation, see Scott Peppet, *Contractarian Economics and Mediation Ethics: The Case for Customizing Neutrality Through Contingent Fee Mediation*, 82 TEX. L. REV 227 (2003).

¹²⁵ See Ron S. Fortgang et al., *Negotiating the Spirit of the Deal*, HARV. BUS. REV., Feb. 1, 2003, at 66 (discussing the problem of intermediaries seeking to push a deal through despite obvious indicators that the deal should not close).

close. Moreover, to earn the parties' trust and confidence, the parties must believe that the mediator is not trying to force them to reach agreement.

We know little about reputational markets for mediators in the litigation context, and nothing about such markets in the transactional arena. The more sophisticated such reputational markets, the less one need worry about self-interested mediators misdirecting transacting parties. In other words, if a transactional mediator acquires a reputation not merely for closing deals, but for closing successful deals or for helping the parties to create value through efficient trades, a mediator will have less incentive to rush to closure. Mediators will moderate their own behavior because it is in their own self-interest to do so.

This presents a paradox, however. One might concede that such sophisticated reputational markets could arise in some contexts, but then doubt that transactional mediators would be necessary in those contexts. Such sophisticated reputational markets are more likely among sophisticated parties—in high stakes mergers, for example, or other contexts in which informed businesspeople transact regularly. If information flows sufficiently freely amongst such parties to rely on markets vis-à-vis a mediator's reputation, isn't it likely that such parties will also be able to conduct their transactions without mediator assistance? Put differently, won't it be easiest to find high-quality mediators in those very contexts in which they are not needed, leaving mediators of lesser or more questionable quality in less sophisticated markets in which their services are more likely to be in demand?

The power of this argument depends on several as-of-yet untested assumptions. First, that mediators will act on their short-term self-interest, particularly reputational interest, to their clients' detriment. Second, that mediators will base their reputations on success rate, defined narrowly. Third, that if a more sophisticated reputational market for mediator services arises, it will necessarily correlate with a decreased need for such services. These assumptions may be inaccurate. Very sophisticated parties will sometimes behave foolishly. In addition, sometimes a sophisticated party will transact with a less sophisticated party—someone less accustomed to the merger context, for example, who does not know “how the game is played” or the relevant norms for completing such a transaction. In those unbalanced transactions, a mediator may be of particular assistance in overcoming emotional and relational breakdowns, transferring information, and facilitating discussion. Finally, potentially disloyal mediators may be constrained by moral considerations, ethics codes, conflict of interest regulations, the threat of malpractice or suit, or fear about establishing a poor reputation.

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I generally assume that the problem of disloyal mediators, although worth consideration, can be managed. Just as mediators' conflicts of interest have been a central concern in the litigation context for some time, so in the transactional context the problem of disloyal mediators will be one of the practical hurdles to overcome. I doubt, however, that concern over disloyalty will significantly depress demand for transactional mediators.

III. BEHAVIORAL JUSTIFICATIONS FOR TRANSACTIONAL MEDIATION

In combination, discovering gains from trade and optimizing gains from trade are the two central economic justifications for mediation. Even if parties are thinking clearly and rationally, they may still behave strategically to their detriment. Thus they may need a mediator's help to overcome these strategic barriers to settlement.

This Part explores how mediators can help contracting parties to manage psychological, emotional, and relational issues that may also impede reaching agreement. This is in keeping with recent work in behavioral law and economics that has highlighted ways in which real negotiators deviate from the assumptions of rational actor models.

A. *Overcoming Psychological Barriers to Negotiation*

In the last decade, negotiation scholars have identified a variety of cognitive and social psychological barriers to the resolution of disputes¹²⁶ and have considered the ways in which a third-party neutral may help parties to overcome these barriers.¹²⁷ Even those more interested in purely economic

¹²⁶ See MAX H. BAZERMAN & MARGARET A. NEALE, NEGOTIATING RATIONALLY 2 (1992) (discussing common decisionmaking biases); Russell Korobkin & Chris Guthrie, *Psychological Barriers to Litigation Settlement: An Experimental Approach*, 93 MICH. L. REV. 107, 160 (1994) (considering how "framing, equity seeking, and reactive devaluation . . . prevent some parties from settling") Russell Korobkin & Chris Guthrie, *Psychology, Economics and Settlement: A New Look at the Role of the Lawyer*, 76 TEX. L. REV. 77, 137 (1997) [hereinafter Korobkin & Guthrie, *Psychology, Economics and Settlement*] (providing experimental evidence that lawyers and clients evaluate settlement options differently). Several seminal early works contributed to this literature on psychological barriers to negotiation. See, e.g., Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, in JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES 20 (1982) (explaining how heuristics parties employ in the face of uncertainty can lead to "systematic and predictable errors").

¹²⁷ See BARRIERS TO CONFLICT RESOLUTION 143 (Kenneth J. Arrow et al. eds., 1995) (summarizing roles of an intermediary in negotiations); Richard Birke & Craig R. Fox, *Psychological Principles in Negotiating Civil Settlements*, 4 HARV. NEGOT. L. REV. 1, 49 (1999) (suggesting that a mutually trusted intermediary may help parties overcome

justifications for mediation acknowledge the importance of these rationales for neutral intervention.¹²⁸ Without reviewing this literature in depth, this section briefly describes some of these barriers to dispute resolution that are equally applicable to transactions and how a transactional neutral might help parties to overcome these barriers.

1. *Fairness Effects*

Neutrals can help contracting parties avoid bargaining inefficiencies caused by fairness effects. In short, people care about fairness and are sometimes willing to kill a deal over it, and their assessments of fairness are often biased and self-serving. A neutral can do more than an agent to overcome the problems this creates.

Economists have long used ultimatum game experiments to probe situations in which fairness concerns cause bargaining inefficiencies. In an ultimatum game, two subjects are given a prize or amount to split. The “proposer” must move first, offering the responder a division of the prize. If the responder accepts the division, each party receives their share of the prize. If the responder rejects the proposed split, each receives nothing.

Classical rational choice models assume that a responder will accept any division, no matter how lop-sided, so long as it pays the responder *something*, given that rejecting the division leads to a zero payoff for the responder. Without reviewing the extensive literature on ultimatum games,¹²⁹ suffice to say that this is not how people actually behave.¹³⁰ Responders

psychological barriers); Robert H. Mnookin, *Why Negotiations Fail: An Exploration of Barriers to the Resolution of Conflict*, 8 OHIO ST. J. ON DISP. RESOL. 235, 248–49 (1993).

¹²⁸ See Brown & Ayres, *supra* note 31, at 329 (“[P]arties to a mediation rarely behave in a purely rational way; overcoming psychological barriers to negotiation will always be an important part of the mediator’s function.”).

¹²⁹ For an overview of ultimatum game literature, see Colin Camerer & Richard H. Thaler, *Anomalies: Ultimatums, Dictators and Manners*, 9 J. ECON. PERSP. 209, 211–12 (1995).

¹³⁰ That individuals sometimes seek fairness instead of purely maximizing self-interest has been a concern of economists for some time. See, e.g., Daniel Kahneman et al., *Fairness and the Assumptions of Economics*, 59 J. BUS. 285 (1986) (exploring how standard economic models can be enriched by taking fairness perceptions into account); Daniel Kahneman et al., *Fairness as a Constraint on Profit Seeking: Entitlements in the Market*, 76 AM. ECON. REV. 728, 729 (1986) (proposing a theory of fairness based on “dual entitlement”); Werner Güth et al., *An Experimental Analysis of Ultimatum Bargaining*, 3 J. ECON. BEHAV. & ORG. 367 (1982). More recently, negotiation analysts have examined fairness seeking in the settlement of disputes. See, e.g., Birke & Fox, *supra* note 127, at 36; Jonathan R. Cohen, *Reasoning Along Different Lines: Some Varied Roles of Rationality in Negotiation and Conflict Resolution*, 3 HARV. NEGOT. L. REV.

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often reject extremely lop-sided proposals, and—anticipating this—proposers often offer more equitable splits than one might expect.¹³¹ Although experimental economics in this area is complex and evolving,¹³² for our purposes the point is simple: transacting parties sometimes are willing to forego doing business together if they feel forced to do so on grossly unfair terms.¹³³

This attention to fairness is made more complex by the fact that behavioral research has shown that parties' interpretations and assessments

111, 117 (1998) (“A party may refuse a settlement that it believes to be unfair even if this refusal functions to the party’s detriment.”).

¹³¹ Under conditions of perfect information a proposer would know the responder’s preferences and tolerances, and could therefore tailor his proposal to ensure that it would be accepted by the responder. In other words, if a given responder would accept no less than \$3 of a \$10 division, the proposer would offer \$3.01. Inefficiencies result from information asymmetries about tolerances. The proposer does not know the responder’s actual preferences, and therefore acts on her own assumptions about what the responder will do. Sometimes this leads to offering too little—as when the proposer offers \$.01 and it is rejected—and sometimes the proposer offers too much.

¹³² See Ernst Fehr et al., *Does Fairness Prevent Market Clearing? An Experimental Investigation*, 108 Q.J. ECON. 437, 438–39 (1993) (experimenting on the impact of fairness on market prices); Ernst Fehr & Klaus M. Schmidt, *A Theory of Fairness, Competition, and Cooperation*, 114 Q. J. ECON. 817, 820–22 (1999) (developing a model of inequity aversion). For a general overview of experimental economics, see Elizabeth Hoffman, *Bibliography of Work on Experimental Economics*, 85 COLUM. L. REV. 1025 (1985).

¹³³ A study by Camerer and Loewenstein illustrates that fairness matters to contracting parties. The experimenters asked MBA students to negotiate over the simulated sale of a piece of land. In the first round, buyers knew only the value of the land and sellers knew only its cost. All negotiating pairs were able to reach agreement. In the second round of the experiment, the same pairs renegotiated after being given full and symmetrical information about cost or value. Despite having more information about their opponent’s reservation price, 20% of pairs failed to reach agreement. Students who had captured a large portion of the available gains from trade in the first round sought to hold onto those gains in the second round. Those students who had not negotiated a favorable agreement in the first round, however, often wanted to be compensated for being treated unfairly. The result was increased bargaining impasse. See Colin F. Camerer & George Loewenstein, *Information, Fairness, and Efficiency in Bargaining*, in *PSYCHOLOGICAL PERSPECTIVES ON JUSTICE: THEORY AND APPLICATION* 155, 178 (Barbara A. Mellers & Jonathan Baron eds., 1993). On the idea of parties turning down Pareto efficient offers if they feel treated unfairly, see Korobkin, *supra* note 66, at 1818 (“[N]egotiators will demand fair deal points and might reject unfair deal points, even when this means turning down a proposed agreement that falls within the bargaining zone.”); Richard Thaler, *Mental Accounting and Consumer Choice*, 4 MKTG. SCI. 199, 205 (1985) (distinguishing “acquisition utility” from “transactional utility”).

of fairness are often self-serving.¹³⁴ In an often-replicated study, for example, subjects designated plaintiffs' or defense counsel, given the same facts about a dispute, and asked to assess the odds of success, tend to think that their own case is stronger than the other side's.¹³⁵ In other words, each side's interpretation of the facts depends on and is biased in favor of its assigned role. Similar experiments have been done regarding wage disputes in the collective bargaining context. Even with symmetrical information, when participants randomly assigned to either the labor or management condition are asked to assess a "fair wage" from a neutral's perspective, they bias their assessments in a self-serving fashion.¹³⁶ Similarly, experiments in the collective bargaining context show that parties are often biased in the comparison data that they select as they attempt to determine what a fair contract price would be.¹³⁷ Raiffa's informal experiments with executives also suggest that self-serving assessments occur in transactions. Executives given extensive information about both an acquiring and target corporation and asked to assess a "fair" price for the transaction consistently make self-interested fairness assessments based on their assigned role in the simulation.¹³⁸

This may contribute to more adversarial negotiations. If I believe that you are being unfair or that I am contributing more to our mutual enterprise,¹³⁹ I am likely to retaliate—as by rejecting a proposal in an

¹³⁴ See Linda Babcock & George Loewenstein, *Explaining Bargaining Impasse: The Role of Self-Serving Biases*, 11 J. ECON. PERSP. 109, 119 (1997); see generally Linda Babcock et al., *Biased Judgments of Fairness in Bargaining*, 85 AM. ECON. REV. 1337 (1995); George Loewenstein et al., *Self-Serving Assessments of Fairness and Pretrial Bargaining*, 22 J. LEGAL STUD. 135 (1993).

¹³⁵ See, e.g., David A. Lax & James K. Sebenius, *The Power of Alternatives or the Limits to Negotiation*, 1 NEGOT. J. 163, 165 (1985) (citing studies).

¹³⁶ See, e.g., Leigh Thompson & George Loewenstein, *Egocentric Interpretations of Fairness and Interpersonal Conflict*, 51 ORG. BEHAV. & HUM. DECISION PROCESSES 176 (1992) (describing a study which concluded that assessments in bargaining are often biased in a self-serving fashion).

¹³⁷ See Linda Babcock et al., *Choosing the Wrong Pond: Social Comparisons in Negotiations that Reflect a Self-Serving Bias*, 111 Q. J. ECON. 1, 16 (1996) (presenting a study showing that "parties involved in labor negotiations select comparison groups in a self-serving fashion, and that the magnitude of this bias helps to predict impasse").

¹³⁸ See RAIFFA, *supra* note 15, at 94.

¹³⁹ Both parties in a negotiation may believe that they are making the majority of the contributions to the deal's success. One early study showed, for example, that a husband and wife may each believe that they are more responsible for doing household chores—cooking, cleaning, shopping, caring for children—than the other. See Michael Ross & Fiore Sicoly, *Egocentric Biases in Availability and Attribution*, 37 J. PERSONALITY & SOC. PSYCHOL. 322, 327 (1979).

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ultimatum game—or to try to capture greater gains for myself.¹⁴⁰ Moreover, people tend to be unaware of the egocentric nature of their fairness assessments.¹⁴¹ Each party is likely to see the other's arguments, claims, and positions as less valid and the other side as less flexible and understanding, while simultaneously interpreting their own actions generously.

Agents can certainly help. An investment banker or lawyer may be experienced with pricing and closing transactions and may counsel her principal not to be overly aggressive or to issue an ultimatum. Similarly, an agent may be better able than her principal to see the self-serving nature of the principal's assessments of the other side. Nevertheless, a neutral may be better able than an agent to help parties overcome such self-serving assessments. An agent may fall prey to the same biases as her principal, whereas a neutral may be less susceptible.¹⁴² A lawyer, for example, may interpret the other side's actions as over-reaching while seeing herself as entirely reasonable. Given that a lawyer's task is to represent a client vigorously and to defend his interests, a lawyer may be predisposed to such biases, as the experiments summarized above seem to suggest.¹⁴³

A neutral, by contrast, is in an ideal position to identify self-serving assessments by one or both parties. At a substantive level, if the neutral has sufficient expertise she can check each side's assumptions about "what's fair" and keep the parties from locking in to diverging stories about how a transaction should be priced or closed. Moreover, the mediator may be able to offer a neutral assessment or fair proposal that the parties will adopt.¹⁴⁴ In

¹⁴⁰ See Kimberly A. Wade-Benzoni et al., *Egocentric Interpretations of Fairness in Asymmetric, Environmental Social Dilemmas Explaining Harvesting Behavior and the Role of Communication*, 67 *ORG. BEHAV. & HUM. DECISION PROCESSES* 111, 124–25 (1996) (showing that egocentric fairness judgments may cause over-claiming in social dilemmas).

¹⁴¹ See Leigh Thompson & Janice Nadler, *Judgmental Biases in Conflict Resolution and How to Overcome Them*, in *THE HANDBOOK OF CONFLICT RESOLUTION: THEORY AND PRACTICE* 213, 224 (Morton Deutsch & Peter T. Coleman eds., 2000) (reviewing literature).

¹⁴² This is an empirical assertion that deserves testing. To date I have found no studies drawing this comparison, although the conclusion I reach here is certainly intuitive.

¹⁴³ See Jean R. Sternlight, *Lawyers' Representation of Clients in Mediation: Using Economics and Psychology to Structure Advocacy in a Nonadversarial Setting*, 14 *OHIO ST. J. ON DISP. RESOL.* 269, 336–38 (1999) (suggesting that lawyers may suffer from overconfidence or have diverging incentives from clients). *But see* Korobkin & Guthrie, *Psychology, Economics and Settlement*, *supra* note 126, at 108 (suggesting that lawyers are less likely than clients to be influenced by such factors).

¹⁴⁴ Russell Korobkin has noted that a mediator can serve to identify a focal point or solution among the range of possible solutions to a dispute. *See* RUSSELL KOROBKIN,

an ultimatum game, for example, Schelling has argued (and shown with a simple experiment) that when a mediator approaches each side and proposes a reasonable split, even without further communication with each other or the mediator, the parties are likely to use that proposal in making their decision.¹⁴⁵ At a procedural or process level, a neutral can also help the parties avoid spinning very biased interpretations of how their bargaining is unfolding. In short, a neutral may be able to mitigate the effects of transacting parties' self-serving assessments of fairness.

2. Reactive Devaluation

Negotiating parties must constantly assess information received from the other side. Sometimes it is wise to doubt the other side's offers and to investigate whether concessions are genuine or somehow duplicitous. Research has shown, however, that negotiators can be overly suspicious. They sometimes overly devalue an opponent's proposal or concession merely because their opponent made it.

For example, imagine that a disputant is considering two possible agreements that would resolve her dispute: Solution A and Solution B. If the disputant knows nothing about the origin of the two solutions, and does not know which solution her opponent favors, she would, all things considered, prefer Solution A. It meets her interests more completely than Solution B. Now imagine that the disputant discovers that Solution A is in fact the offer proposed by her opponent. Research shows that this information about the offer's origin will often taint a disputant's evaluation of the merits of the two proposals. She may no longer prefer Solution A, merely because the other side proposed it.

This phenomenon is known as "reactive devaluation." Others have reviewed the reactive devaluation literature and its most famous examples.¹⁴⁶ For our purposes the point is clear: reactive devaluation can obviously make it difficult to reach agreement.¹⁴⁷ If each side devalues the other's proposals, they may never find a mutually-agreeable resolution to their dispute.

NEGOTIATION THEORY AND STRATEGY 352-53 (2002) ("[A] mediator's recommended settlement . . . can itself serve as an independent focal point that can justify both parties' agreement.").

¹⁴⁵ See SCHELLING, *supra* note 35, at 62-63, 63 n.4 (describing the problem and a simple experiment showing that people settled on the mediator's focal point).

¹⁴⁶ See Birke & Fox, *supra* note 127, at 48-49; Korobkin & Guthrie, *Psychology, Economics and Settlement*, *supra* note 126, at 150-53; Sternlight, *supra* note 143, at 312-13.

¹⁴⁷ See Lee Ross & Constance Stilling, *Barriers to Conflict Resolution*, 7 NEGOT. J. 389, 394-95 (1991); see also Lee Ross, *Reactive Devaluation in Negotiation and*

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Reactive devaluation could be just as pronounced in transactional bargaining as in disputes. A buyer might devalue a seller's offer, sure that it is biased in the seller's favor. A corporate attorney might distrust the other side's first draft of a contract, and automatically "devalue" the terms therein without truly examining those terms to determine whether any of them are sensible. If each side reactively devalues the other's proposals, bargaining may become unnecessarily adversarial.

Unlike an agent, a neutral can help parties to overcome reactive devaluation in transactional bargaining by either adding noise to the parties' communication or proposing solutions of her own. Adding noise may be as simple as raising Party A's proposed solution privately with Party B without telling B that the idea came from Party A. If B assumes that the idea originated with the neutral, B may be more willing to consider it on the merits.

In addition, a transactional neutral might propose solutions of her own. Although many "facilitative" mediators in the litigation context criticize those neutrals who are willing to give parties a neutral evaluation of the merits of a case or direct them towards a particular solution,¹⁴⁸ empirical research shows that many, and perhaps most, neutrals do in fact engage in some sort of case evaluation to help settle litigation.¹⁴⁹ In transactions, mediators could similarly propose terms and conditions or packages of trades that the parties had not considered. As Thomas Schelling has explained:

[A] mediator can do more than simply constrain communications—putting limits on the order of offers, counter-offers, and so forth—since he can invent contextual material of his own and make potent suggestions. That is, he can influence the other player's expectations on his own initiative When there is no apparent focal point for agreement, he can create one by his power to make a dramatic suggestion.¹⁵⁰

Conflict Resolution, in BARRIERS TO CONFLICT RESOLUTION 34 (Kenneth J. Arrow et al. eds., 1995).

¹⁴⁸ The debate between facilitative and evaluative mediators is long-standing and complex. See, e.g., Leonard L. Riskin, *Understanding Mediators' Orientations, Strategies, and Techniques: A Grid for the Perplexed*, 1 HARV. NEGOT. L. REV. 7, 24–38 (1996) (discussing the debate and offering a framework for analysis).

¹⁴⁹ See Roselle L. Wissler, *Court-Connected Mediation in General Civil Cases: What We Know from Empirical Research*, 17 OHIO ST. J. ON DISP. RESOL. 641, 656 (2002) (reporting that mediators evaluated for the parties in 31% of cases, suggested possible settlement options in 69% of cases, and recommended a particular settlement option in 28% of cases); *id.* at 656 n.58 (citing other studies).

¹⁵⁰ SCHELLING, *supra* note 35, at 144.

Whatever its other benefits or drawbacks, at the very least directing parties in this way may overcome the effects of reactive devaluation.

3. *Framing and Endowment Effects*

Economics has traditionally assumed that a negotiator's preferences are exogenous vis-à-vis a good to be traded. In other words, although a given negotiator might prefer the good more and another less, how much someone cares for a particular good should not be affected by whether that person is buying or selling it.

Behavioral research suggests, however, that preferences may vary depending on the initial allocation of resources or property. People tend to overvalue items they own as compared to items they do not.¹⁵¹ In other words, people demand more to give up something they already own than they will offer to purchase the same item. In one classic study, experimenters gave subjects a coffee mug and offered them a choice to keep the mug or to sell it for an unspecified but predetermined price. These subjects had to write down the price at which they would sell the mug. Another group did not receive mugs. Instead, they had to write down how much they were willing to pay to acquire one. The study found that the median asking price for sellers was \$7.12, whereas the median offer price from buyers was \$2.87.¹⁵²

A further experiment showed that such endowment effects can inhibit bargaining and trades. The experimenters again gave some subjects coffee mugs. This time, however, the subjects with mugs were paired with a bargaining counterpart to whom they could sell the mugs. As the endowment effect would predict, fewer trades occurred than one would expect. Sellers required more than buyers were willing to pay.¹⁵³ Similarly, research has shown that subjects' investment decisions—whether to invest in high-risk, moderate risk, or low-risk investments—can vary depending on whether the subject makes the choice from a clean slate (holding no existing securities) or already has certain securities in his portfolio.¹⁵⁴ And recent studies in the

¹⁵¹ For an overview of this literature, see Elizabeth Hoffman & Matthew L. Spitzer, *Willingness to Pay vs. Willingness to Accept: Legal and Economic Implications*, 71 WASH. U. L.Q. 59, 61 (1993); Daniel Kahneman et al., *Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias*, 5 J. ECON. PERSP. 193, 194–97 (1991).

¹⁵² See Daniel Kahneman et al., *Experimental Tests of the Endowment Effect and the Coase Theorem*, 98 J. POL. ECON. 1325, 1339 (1990); see generally Jack L. Knetsch & J.A. Sinden, *Willingness to Pay and Compensation Demanded: Experimental Evidence of an Unexpected Disparity in Measures of Value*, 99 Q.J. ECON. 507 (1984) (conducting a similar experiment).

¹⁵³ See Kahneman et al., *supra* note 152, at 1340–41.

¹⁵⁴ See William Samuelson & Richard Zeckhauser, *Status Quo Bias in Decision*

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legal domain suggest that contracting parties may prefer status quo contract terms more than novel ones.¹⁵⁵

A neutral may be less susceptible to the endowment effect than a partisan agent,¹⁵⁶ and therefore able to help parties to overcome it. For example, a neutral may be able to provide both sides with market information against which they can test their (biased) evaluations. This is particularly plausible vis-à-vis the legal terms and conditions in a contract.¹⁵⁷ A lawyer-neutral might be familiar with the legal norms in a given context and be able to point the parties towards compromise legal language. Similarly, the lawyer might be able to help the parties overcome their reliance on status quo legal terms—or the formulaic terms used in standard form contracts—and innovate based on their interests and preferences. Rather than start with a standard form or with a first draft, which would typically become the original endowment against which the parties compared, the neutral could manage the negotiation process so that the parties instead would work collaboratively to build a contract draft from framework through to completion.¹⁵⁸ The neutral

Making, 1 J. RISK & UNCERTAINTY 7, 31 (1988) (finding that only 28% of TIAA/CREF retirement fund participants had ever changed their distribution of premium between stocks and bonds despite large annual variations in rates of return and the fact that they could do so for free).

¹⁵⁵ See Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CAL. L. REV. 1051, 1104–08 (2000) (providing an overview of prospect theory, framing effects, and status quo bias); see also Russell Korobkin, *Inertia and Preference in Contract Negotiation: The Psychological Power of Default Rules and Form Terms*, 51 VAND. L. REV. 1583, 1588–93 (1998) (providing experimental evidence).

¹⁵⁶ This is an empirical proposition about which I can find no empirical research. Nevertheless, the proposition seems intuitively sound. To the extent that an agent takes on the principal's interests as her own, she may be subject to the same loss aversion that drives the endowment effect in her principal's assessments. A neutral, however, is unlikely to feel loss aversion or, conversely, attached to the status quo.

¹⁵⁷ A neutral might also help two contracting parties overcome endowment effects in valuation or pricing. This is somewhat less likely, however, for the following reason. If a neutral were able to accumulate accurate information about the correct price for a given sort of transaction—such as the purchase of residential real estate or the sale of corporate assets—the neutral would be well-positioned to exploit that information for his own advantage by trading upon it for his own account. In other words, by the time the neutral had invested sufficiently in acquiring such information, the neutral could participate in the market as a principal rather than as a neutral. Indeed, in some markets we see *agents* participating as principals. For example, a residential real estate broker might “pick off” properties that she knows are especially cheap. If neutrals (or agents) with superior pricing information leave the market in this way, it is unlikely that the remaining neutrals will have a great deal more information relevant to pricing than the principals already possess.

¹⁵⁸ See FISHER ET AL., *supra* note 70, at 112–16 (suggesting this sort of “one text”

might thus help the parties to overcome their tendency to prefer those terms or conditions that they viewed as their original “endowment.”

B. *Managing Attributions, Emotions, and Relationships*

In addition to managing information exchange and helping parties to overcome these cognitive and social psychological biases, a neutral can help parties to manage emotional and relational difficulties in their negotiations.¹⁵⁹ This may facilitate trust and permit more efficient outcomes. This section briefly explains why a transactional neutral may be better able than an agent to overcome the most challenging relational problems that contracting parties face.

1. *Attributions and Emotions*

People tend to try to explain the events they experience, even if doing so requires inventing attributions or stories about others, circumstances, and causation.¹⁶⁰ Sometimes these attributions are internally-oriented—a negotiator attributes her failure in getting a good deal to her own inadequacies as a bargainer or to her lack of preparation. Often, however, we focus our attributions on others. A negotiator explains her poor outcome by focusing on the other side’s intentional actions (*e.g.*, “they tricked me”) or the circumstances (*e.g.*, “there wasn’t enough time to negotiate properly”).¹⁶¹

Sometimes, of course, one’s attributions about others are correct—the other person *is* trying to trick you. Often, however, our attributions are inaccurate and biased. Research has identified several such biases. The most important is the fundamental attribution error, which refers to the tendency to overestimate the importance of disposition and underestimate the ways in

procedure for international and other negotiations).

¹⁵⁹ The transformational mediation literature has elevated this aspect of mediation to primary importance. See ROBERT A. BARUCH BUSH & JOSEPH P. FOLGER, *THE PROMISE OF MEDIATION* 79 (1994). Although I do not place quite that much importance on this aspect of a mediator’s role, I do think that relationship-management can be beneficial in the business context as well as in litigation. See, *e.g.*, Shell, *supra* note 75, at 252–53 (“[N]egotiation is a laboratory for the construction of relationships between business actors.”).

¹⁶⁰ For an excellent overview of attribution theory and its relation to conflict, see Keith G. Allred, *Accusations and Anger: The Role of Attributions in Conflict and Negotiation*, in *THE HANDBOOK OF CONFLICT RESOLUTION: THEORY AND PRACTICE* 236 (Morton Deutsch & Peter T. Coleman eds., 2000).

¹⁶¹ See Dan Coates & Steven Penrod, *Social Psychology and the Emergence of Disputes*, 15 *LAW & SOC’Y REV.* 655, 660 (1980–81) (reviewing literature on early attribution theory).

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which another's actions were caused by circumstance.¹⁶² For example, when a person cuts you off in traffic you are more likely to think "they are driving that way because they are inconsiderate" than "they may be driving that way because they are late to their child's medical appointment." In addition, we tend to display the "actor-observer bias," which refers to a person's tendency to over-attribute his *own* behavior to circumstance rather than to his own habits or disposition.¹⁶³ In short, we hold others to an overly high standard while simultaneously letting ourselves off too easily.¹⁶⁴

In conflict situations, our interpretations can also be biased by the way we "punctuate," and thus explain, a series of events. As Thompson and Nadler explain:

Actor A perceives the history of conflict with another actor, B, as a sequence of B-A, B-A, B-A, in which the initial hostile or aggressive move was always made by B, obliging A to engage in defensive and legitimate retaliatory action. Actor B punctuates the same history of interaction as A-B, A-B, A-B, however, reversing the roles of aggressor and defender When each side . . . is queried, they explain their frustrations and actions as defenses against the acts of the other party.¹⁶⁵

This "biased punctuation of conflict" means that each side may believe that the other is responsible for any tensions in a negotiation, and each feels justified in "retaliating" or escalating.

These attributions come with attendant emotions. In particular, if you attribute the cause of your failure to another's intentional harmful actions, you are most likely to become angry and seek retaliation. This is not a trivial problem. Research has shown that angered negotiators tend to pay less attention to each others' interests and to find fewer mutually-beneficial solutions than those who are not angry.¹⁶⁶ Anger leads to a desire to

¹⁶² See Allred, *supra* note 160, at 240 ("Research indicates that when people err in attributing other people's behavior, they do so on the side of inferring too quickly and easily that a given behavior is the result of disposition while largely ignoring information indicating that circumstances cause the behavior.").

¹⁶³ See *id.* at 240-41 (describing actor-observer bias).

¹⁶⁴ Allred et al. have shown that the fundamental attribution error and the actor-observer bias can lead to both an "accuser bias" (a tendency for an actor harmed by another's actions to assume that those actions were under that actor's control) and a "bias of the accused" (a tendency to assume that one's own harmful behavior was caused by circumstance rather than factors within one's control). See *id.* at 244 (reviewing study).

¹⁶⁵ Leigh Thompson & Janice Nadler, *Judgmental Biases in Conflict Resolution and How to Overcome Them*, in THE HANDBOOK OF CONFLICT RESOLUTION: THEORY AND PRACTICE 213, 217 (Morton Deutsch & Peter T. Coleman eds., 2000).

¹⁶⁶ See Allred, *supra* note 160, at 244; see also Keith G. Allred et al., *The Influence*

retaliate—to try to get the best deal possible for oneself or damage the other side rather than working collaboratively.¹⁶⁷ This, in turn, provides the other side with new evidence that its counterpart is untrustworthy and opportunistic. Each side “reacts” to the other, and as misattributions and emotions pile up, parties may become increasingly guarded, adversarial, and untrusting. This hampers efforts to negotiate a deal.

It is not easy for parties to pull themselves out of this destructive cycle. If one’s anger is grounded in mis-attributions about others, circumstance, or causation, simply venting that emotion or taking time to “cool off” is unlikely to be productive and can instead make matters worse.¹⁶⁸ Instead, negotiators must unpack the series of attributions and judgments that gave rise to their emotions. By empathetically taking the other person’s point of view and attempting to tell the story of what happened from their perspective, a negotiator can test her attributions and unravel those that are unfounded.¹⁶⁹ This is often difficult to do. Once saddled with their respective attributions and attendant emotions, two negotiators may be unable to step out of their own shoes and into each other’s.

2. *Attributions and Emotions in Transactions*

Like disputes, transactional negotiations are certainly not immune from emotions and attributions. Tempers flare, accusations are made, and relationships sour. Mergers and acquisitions, for example, can give rise to intense emotional disagreements that put great strain on the underlying business relationships.¹⁷⁰ As Robert Kindler, an M&A partner at Cravath,

of Anger and Compassion on Negotiation Performance, 70 *ORG. BEHAV. & HUM. DECISION PROCESSES* 175, 183 (1997) (“Negotiators who held each other more responsible for negative behavior felt more negative emotional regard for each other . . . which led to less regard for the other party’s interests . . . which led to less accurate judgments of each other’s interests . . . which lead to fewer joint gains . . .”).

¹⁶⁷ See Joseph P. Daly, *The Effects of Anger on Negotiations over Mergers and Acquisitions*, 7 *NEGOT. J.* 31, 35 (1991) (reporting the M&A players sometimes wanted merely to “teach them a lesson” rather than optimize deal terms).

¹⁶⁸ See, e.g., Keith G. Allred, *Anger and Retaliation: Toward an Understanding of Impassioned Conflict in Organizations*, in 7 *RESEARCH ON NEGOTIATION IN ORGANIZATIONS* 27 (R.J. Bies et al., eds. 1999) (describing the problems with venting); Robert S. Adler et al., *Emotions in Negotiation: How to Manage Fear and Anger*, 14 *NEGOT. J.* 161, 171 (1998) (“What is needed, instead, is time spent . . . reassessing the situation . . .”).

¹⁶⁹ See MNOOKIN ET AL., *supra* note 4, at 46–47 (describing importance of empathy and perspective-taking); Allred, *supra* note 168.

¹⁷⁰ See Daly, *supra* note 167, at 35 (reviewing interviews with participants in M&A negotiations and discussing the role of anger).

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Swaine & Moore has said, “Even transactions that make absolute economic sense do not happen unless the social issues work.”¹⁷¹ Particularly if one party is more accustomed to negotiations than another or more sophisticated with doing deals in a particular context, transacting parties may spend a great deal of time and energy on these relational issues.

Consider the example of recent merger negotiations between SmithKline Beecham and Glaxo Wellcome. In February 1998, a deal was announced that promised to create a pharmaceutical giant with annual sales of \$25 billion. The combination was much applauded by industry and Wall Street analysts.¹⁷² Nevertheless, three weeks into the merger negotiations, the companies’ CEOs managed to kill the deal. In essence, Sir Richard Sykes, the CEO of Glaxo, put an ultimatum offer to Jan Leschley, the CEO of SmithKline that effectively removed Leschley and SmithKline from the management structure of the new entity. Leschley walked, incensed at Sykes’ audacity. The next day, the combined market valuation of the two companies dropped by \$19 billion, destroying the significant run-up each had enjoyed as a result of the disclosure of merger negotiations. Although several months later Sykes hinted that he was willing to renew discussions,¹⁷³ Leschley signaled that he was uninterested. Despite calls from the investment community to overcome their differences, the Glaxo SmithKline deal remained off the table until September of 1999, when Leschley announced his decision to retire and Jean-Pierre Garnier was named as his successor at SmithKline. Negotiations began again in earnest, and in January 2000, the merger was re-announced. It was ultimately completed on December 27, 2000, creating GlaxoSmithKline. Ironically, neither of the original CEOs controls the new entity: Leschley plays no part, Sykes plays the diminished role of non-executive Chairman, and Garnier is CEO.¹⁷⁴

The GlaxoSmithKline example illustrates that negotiation breakdowns occur in transactional bargaining, sometimes to the detriment of both parties. To some extent, agents such as investment bankers and lawyers already serve to mediate emotional conflicts during mergers, acquisitions, and other transactions. One interview-based study, for example, found that:

¹⁷¹ BRAMS & TAYLOR, *supra* note 59, at 126 (quoting Kindler).

¹⁷² See *The UK Drugs Champion*, FIN. TIMES Feb. 2, 1998, at 17 (“There is no shortage of superlatives to apply to the proposed merger between Glaxo Wellcome and SmithKline Beecham.”).

¹⁷³ See Daniel Green, *Glaxo Still Willing on SB Merger*, FIN. TIMES, Apr. 4, 1998, at 19.

¹⁷⁴ See David Pilling, *Tonic for the Troops: Man in the News Jean-Pierre Garnier*, FIN. TIMES, Jan. 22, 2000, at 15.

[I]nvestment bankers . . . credit intermediaries [such as themselves] with preventing anger from killing a deal. [They] claimed that by keeping the parties physically separated at times, serving as communication channels, and filtering out relationship-threatening messages, intermediaries are able to consummate deals that would not have taken place had the parties negotiated face-to-face.¹⁷⁵

Moreover, game theory has long suggested that repeat play may help to stimulate and stabilize cooperation.¹⁷⁶ Although few parties litigate against one another more than once, lawyers do sometimes oppose each other repeatedly. Attorneys may thus turn a one-shot game into an iterative one, suggesting the possibility of increased cooperation.¹⁷⁷ Recent empirical work indicates that this may in fact hold true in legal disputes.¹⁷⁸ Similarly, transactional agents may have incentives to build a reputation for “getting the deal done.”¹⁷⁹ Even if their principals have not worked together before (which may be more likely than in the litigation context), the agents may have a sufficiently-established relationship to overcome mis-attributions and emotions.

A neutral sometimes has an advantage over an agent in this regard, however.¹⁸⁰ An agent can fall prey to the same attribution errors as her principal. In discussions with a client, a lawyer, real estate agent, or banker may try to mollify the client rather than test the client’s perhaps biased story about the other side. In the worst-case scenario, an agent may fan the flames and aggravate a client’s emotions. But even without trying to escalate a

¹⁷⁵ Daly, *supra* note 167, at 37; *see also* Alan K. Wells, *Acquisition Intermediaries: Purveyors of Opportunity*, in *DIRECTORY OF M&A INTERMEDIARIES* 13, 14 (2001) (“Intermediaries will often . . . mediate emotionally charged negotiations to insure that the deal is closed in a reasonable amount of time.”).

¹⁷⁶ *See generally* ROBERT AXELROD, *THE EVOLUTION OF COOPERATION* (1984).

¹⁷⁷ *See, e.g.*, Ronald J. Gilson & Robert H. Mnookin, *Disputing Through Agents: Cooperation and Conflict Between Lawyers in Litigation*, 94 *COLUM. L. REV.* 509 (1994).

¹⁷⁸ *See* Jason Scott Johnston & Joel Waldfogel, *Does Repeat Play Elicit Cooperation? Evidence from Federal Civil Litigation*, 31 *J. LEGAL STUD.* 39, 59 (2002).

¹⁷⁹ *See* Scott, *supra* note 99 (discussing the importance of reputation in contracting).

¹⁸⁰ *See* BERNARD MAYER, *THE DYNAMICS OF CONFLICT RESOLUTION* 206–07 (2000) (exploring how mediators help parties manage emotions); *DICTIONARY OF CONFLICT RESOLUTION* 287 (Douglas H. Yarn ed., 1999) (“Hostility, anger, and other emotions often impede productive discussion on substantive issues in dispute. A mediator may use a variety of techniques to manage destructive emotions and reconcile the disputants.”); Allred, *supra* note 160, at 250 (“The mediator can help the accuser take the perspective of the accused for the purpose of taking stock of those mitigating factors beyond the control of the accused.”).

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conflict, an agent may naturally take his client's perspective as given and discount the likelihood that the other side has a valid interpretation of events or more benign intentions than the client understands.

A neutral positioned between two parties can often help them to gain such perspective. As discussed above, anger is often driven by mis-attributions about another person's motivations. In strategic situations it is easy to assume that when the other bargainer "starts high" or "holds out," they do so because they intend to harm you or to treat you unfairly. Bargainers are less likely to attribute such actions to the exigencies of circumstance. By screening some overly opportunistic offers and at times sending fuzzy rather than clear information between the parties, a mediator can blunt such emotions and thereby keep the negotiations on track.¹⁸¹ Over time, avoiding emotional disagreements may help the parties to establish trust.

This not only leads to more amiable negotiations, but also has serious substantive benefits. As mentioned above, if the parties trust each other they may be better positioned to find value-creating solutions to their substantive differences. They may be able to rely more on informal agreements rather than contractual obligations¹⁸² and may be more flexible in the face of unexpected bumps in the road. Perhaps most importantly, they may avoid the destructive cycle of mis-attributions that can lead parties to "blow up" a deal or reach a Pareto-inefficient agreement.

IV. PRELIMINARY EVIDENCE OF TRANSACTIONAL MEDIATION

Parts II and III made the case that mediators can add value in transactions. In particular, I argued that mediators can manage information exchange to overcome adverse selection, at least in transactions that take on bilateral monopoly characteristics. I further suggested that this may be especially true of legal negotiations over contractual terms and conditions, which may often take on such characteristics.

¹⁸¹ See LAX & SEBENIUS, *supra* note 35, at 174 (discussing this role for a mediator); see also Debra A. Gilin & Paul W. Paese, *Mediation as Persuasion: Central Route Attribution Change as a Conflict Resolution Technique* (unpublished manuscript, on file with author) (reporting study showing that mediation intervention helped conflicting parties unravel attributions and de-escalate emotions).

¹⁸² Fuller suggested that a mediator can help parties to shift their relationship from one based on rights and duties to one based on trust, cooperation, and reciprocity. This, he argued, can "enable them to meet shared contingencies without the aid of formal prescriptions laid down in advance." Lon L. Fuller, *Mediation—Its Forms and Functions*, 44 S. CAL. L. REV. 305, 326 (1971). In other words, parties can come to rely on trust and respect rather than on contractual obligation.

Given these potential benefits, the most obvious objection to the argument laid out so far is economic and empirical: if mediators could be so helpful in transactions, there should already be a market for their services. Social and economic roles that create value evolve into robust institutions; those that do not fail to thrive. As already discussed, to date there has been little evidence that mediators are serving in transactions. This suggests *prima facie* that the market does not need mediator assistance in contract formation.

It is extremely difficult to know whether, how, and how often mediators currently serve in transactional bargaining. As indicated, almost no research has been conducted in this area. Nevertheless, we do know that mediators are involved in *some* pre-closing negotiations over contract formation. As already noted, the most common example is collective bargaining. Whether mediators intervene in other sorts of transactions, however, is something of a mystery.

On the one hand, the lack of discussion or promotion of transactional intervention by the mediation community may suggest that few are doing such work. With the exception of one practitioner's article arguing for transactional mediation in the international context,¹⁸³ few mediators seem to discuss or even be aware of this possibility. As one might expect, the major associations of mediators are singularly dispute focused. Review of the committees, sections, and workshop topics of the Association for Conflict Resolution—one of the largest groups of mediators and dispute resolution professionals in the United States—shows no interest in transactional mediation. Its Internet site defines ADR as “a wide range of processes that encourage nonviolent dispute resolution outside of the traditional court system,” and its discussion of the benefits of mediation focuses on its efficiencies as compared to litigation.¹⁸⁴

The same is true of the American Bar Association's Section on Dispute Resolution, which was established in 1993 and has over 7,500 members.¹⁸⁵ The Section publishes a Guide to Dispute Resolution Processes, meant to be an introduction for attorneys to the field of ADR and mediation. The Guide describes such processes as “alternatives to having a state or federal judge or jury decide the dispute in a trial,”¹⁸⁶ again suggesting that the Section is focused on resolving litigated disputes. In addition, the Section publishes the

¹⁸³ See L. Michael Hager & Robert Pritchard, *Deal Mediation: How ADR Techniques Can Help Achieve Durable Agreements in the Global Markets*, 14 ICSID REV.-FOREIGN INVESTMENT L.J. 1, 2–3 (1999).

¹⁸⁴ See <http://www.acresolution.org> (last visited Apr. 5, 2002).

¹⁸⁵ See <http://www.abanet.org/dispute/home.html> (last visited Sept. 21, 2003).

¹⁸⁶ See AMERICAN BAR ASSOCIATION, WHAT YOU NEED TO KNOW ABOUT DISPUTE RESOLUTION: THE GUIDE TO DISPUTE RESOLUTION PROCESSES, *available at* <http://www.abanet.org/dispute/draftbrochure.pdf> (last visited Jan. 21, 2004).

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Model Standards of Conduct for Mediators. This too focuses on disputes, defining mediation as a “process in which an impartial third party—a mediator—facilitates [the resolution of a dispute by promoting] voluntary agreement (or ‘self-determination’) by the parties to the dispute.”¹⁸⁷ Although one might interpret “dispute” broadly in this definition in order to include transactional intervention,¹⁸⁸ it seems unlikely that this was the Section’s intention.

Finally, the CPR Institute for Dispute Resolution in New York, which has played a major role in bringing mediation and other forms of dispute resolution to the corporate sector, is litigation oriented. Although the Institute has sponsored some discussion of transactional ADR,¹⁸⁹ the vast majority of its resources and publications focus on mediation and arbitration in the litigation context. Similarly, major ADR training organizations have largely ignored transactional issues.¹⁹⁰

On the other hand, my own survey of 122 practicing mediators unearthed forty-eight who claimed to have served as a transactional mediator. This survey was designed simply to trawl for mediators in hopes of determining whether dispute mediators were also being hired in the transactional context.¹⁹¹ The survey asked respondents for information about their education and training, their experience as a dispute mediator, and their experience as a transactional mediator.¹⁹² In the section on transactional

¹⁸⁷ See AMERICAN BAR ASSOCIATION, MODEL STANDARDS OF CONDUCT FOR MEDIATORS, available at <http://www.abanet.org/ftp/pub/dispute/modstan.txt> (last visited Sept. 21, 2003).

¹⁸⁸ See *infra* notes 227–36 and accompanying text.

¹⁸⁹ See *CPR’s Online Seminar: Transactional ADR*, 19 ALTERNATIVES TO HIGH COSTS OF LITIG. 173 (July–Aug. 2001) (transcript of panel discussion on the possibilities of transactional mediation).

¹⁹⁰ For example, the web site for CDR Associates in Boulder, Colorado—a national mediation and training organization—similarly focuses on the resolution of litigation. See <http://www.mediate.org> (last visited Sept. 21, 2003).

¹⁹¹ I recognize that some professionals who do not self-identify as mediators or who do not belong to recognized mediation associations may nevertheless be serving as mediators in transactions. However, I had no way to identify or contact such people. As a result, I focused the survey on existing dispute mediators in hopes of identifying whether any such mediators also worked in the transactional arena.

¹⁹² To distinguish transactional from dispute mediation I asked the following question:

Have you ever served as a mediator in a *transaction* as opposed to in a *dispute*? (By this I mean helping two transacting parties to negotiate their contract or deal agreement in advance of the deal taking place. It does NOT include mediating a dispute that arises after a transaction or as a result of a contract. For example, transactional mediation would include helping a buyer and seller complete the sale of a home or

work it asked how often the respondent had engaged in transactional mediation and allowed the respondent to indicate in how many of various types of transactions he or she had intervened.¹⁹³ The survey then asked the respondent to describe the largest (in dollars) transaction they had worked on, and to indicate what sorts of functions they fulfilled in that mediation.¹⁹⁴

I posted the survey on a web site and emailed over five hundred mediators, inviting them to fill out the survey on-line. I make no claim that the sample was random or representative of all practicing mediators—lacking any systematic and efficient way to contact large numbers of mediators, I simply searched leading mediation-related Internet sites for email addresses. After reviewing the results, I eliminated any respondents whose responses suggested confusion about the survey or the definition of transactional mediation, and contacted some of those who indicated that they had served as a transactional mediator to verify the information provided and clarify that the respondent was indeed reporting the type of mediation I was focused upon. This weeded out false positives.

The survey results are intriguing. Over forty mediators claimed to have been involved in a transactional mediation. They indicated that they had served as mediators in various types of transactions, including residential real estate, commercial real estate, business formation, mergers and acquisitions, joint ventures, and both union and non-union employment agreement

business, but would *not* include resolving litigation that arose *after* the sale of the house or business.)

In retrospect, the definition may have been too narrow: it suggests that interventions in the renegotiation stage are excluded. Focusing this initial survey primarily on pre-closing negotiations served my purposes here, however, as I was most curious about whether I would find *any* such transactional mediator interventions.

¹⁹³ The types included: union/labor management contract formation, non-union employment agreement formation, residential real estate transaction, commercial real estate transaction, sale of a small business (under \$5 million), merger of two businesses, sale of a major business or business unit (over \$5 million), formation of a business or partnership, creation of a joint venture between two or more businesses, other.

¹⁹⁴ The list of functions included: introducing the parties to each other (serving as a matchmaker); comparing offers and counteroffers to see if a deal was possible; shuttling information back and forth between the parties; helping the parties find creative solutions or trades; proposing creative solutions or trades that the parties had not thought of; helping the parties agree on legal language to include in their contract; proposing legal language that the parties had not thought of; helping manage the process by setting an agenda, timekeeping, etc.; helping the parties overcome strong emotions, anger, etc.; interviewing each party privately about their interests, needs, priorities; providing an independent assessment of the value of the transaction; helping to verify important information about the deal; helping the parties plan for future disputes (such as by including a dispute resolution clause in their contract); serving as a mediator after the deal was closed to resolve ongoing or future disputes between the parties); and others.

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negotiations.¹⁹⁵ Examples included assisting with negotiations over the formation of a partnership of practicing physicians, the sale of a motorcycle dealership, the formation of pre-nuptial agreements and domestic partnerships, re-allocation of property rights and governance in a golfing community, the establishment of a joint venture between a small business and a Fortune 500 company, the sale of cable television access rights, formation of a cross-country ski league, the creation of a houseboat community association, the creation of a joint venture to produce software, negotiations over the terms of a real estate brokerage contract, the transfer of control within a closely held software development firm, the formation of a partnership to own an airplane (where the parties needed to work out issues as varied as fees and the placement of stickers on the tail fin), the negotiation of angel funding for a privately held business, and mergers between two or more corporations. These transactions ranged in value from \$100,000 to \$26 million.

None seemed to make transactional mediation their primary practice. Of the forty-eight respondents who had conducted a transactional mediation, twenty-seven had done ten or fewer such interventions, and of those, twelve had done only one or two. Although only thirty-one respondents (of these forty-eight) provided sufficient information to draw a comparison between how many dispute mediations and how many transactional interventions they had done, of those who did give such information, it seemed clear that transactional work was a small fraction (average 6.14%) of their portfolio of mediations.¹⁹⁶ These thirty-one respondents had each conducted an average of 409 total mediations (maximum 1,500, minimum 50, standard deviation 344), and an average of only 12 transactional mediations (maximum 67, minimum 1, standard deviation 13).¹⁹⁷

¹⁹⁵ I expected that many respondents would report experience with labor-management negotiations and that this might bias the results. In fact, only one of the 48 respondents with transactional experience was *solely* a labor-management mediator. Twelve others had some labor-management experience but also reported experience with others types of transactional intervention.

¹⁹⁶ These respondents obviously distinguished between the many dispute cases they had mediated and the few transactional mediations in which they had participated. This suggests that they understood the distinction I was trying to draw in the survey.

¹⁹⁷ The mediators in the survey with transactional experience had practiced mediation slightly longer (average 12 years mediation experience) than their peers in the survey who had not (average 8 years mediation experience). In addition, 108 respondents gave information on whether they were licensed as attorneys and/or were currently practicing as attorneys. Of the 44 transactional mediators that gave such information, only 10 (or 23%) were not attorneys. Of the 64 respondents who gave such information and who had had no involvement in transactional mediation, 31 (or 48%) were not attorneys. This supports—although it obviously does not prove—my contention that a

These results suggest that mediators do intervene occasionally in transactions pre-closing. Although I place no stock in the fact that such a high percentage of those surveyed had done so (because the sample was not random), I had initially set out merely to find whether *any* such interventions are occurring. The survey at least indicates that mediators *are* sometimes asked to facilitate transactions.

Whether mediators are currently involved in transactions to a greater extent than suggested here is obviously an empirical question deserving additional study. The publication of this Article may help to bring forward dispute mediators and others currently working in this capacity. These preliminary results suggest that some mediators are working in transactions but that it is not a widespread practice. Nevertheless, the results strengthen both the case for transactional mediators and the need for more coherent understanding and regulation of their practice. Part V now turns to the latter issue.

V. IMPLICATIONS

In February 2002, the American Bar Association's House of Delegates approved the Ethics 2000 Committee's proposed revisions to the Model Rules of Professional Conduct. Included in that revision is a new Rule 2.4 governing lawyers serving as mediators. Although Rule 2.4 was originally drafted only to cover mediators serving in disputes,¹⁹⁸ the Rule as adopted clearly extends to transactional mediation. The text of the rule defines a mediator, stating that "[a] lawyer serves as a third-party [mediator] when the lawyer assists two or more persons who are not clients of the lawyer to reach a resolution of a dispute *or other matter* that has arisen between them."¹⁹⁹ The Rule's Comments are more explicit. Comment 1 to Proposed Rule 2.4 states that "[a] third-party [mediator] is a person, such as a mediator, arbitrator, conciliator or evaluator, who assists the parties, represented or unrepresented, in the resolution of a dispute *or in the arrangement of a*

lawyer may have special advantages in this sort of intervention.

¹⁹⁸ See MODEL RULES OF PROF'L CONDUCT R. 2.4(a) (Proposed Rule 1999) (on file with author).

A lawyer serves as a third-party [mediator] when the lawyer assists two or more persons who are not clients of the lawyer to reach a *resolution of disputes* that have arisen between them. Service as a third-party [mediator] may include service as an arbitrator . . . [or] a mediator . . . , or in such other capacity as will enable the lawyer impartially to assist the parties to resolve their dispute.

Id. (emphasis added).

¹⁹⁹ *Id.* (emphasis added).

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transaction.”²⁰⁰ In choosing this broad definition of mediation, the drafters apparently assumed that a lawyer-mediator could play some useful role in dealmaking.²⁰¹

I certainly applaud this progressive definition in Rule 2.4. As Parts II and III indicated, lawyers may have special advantages as transactional mediators in some contexts, and therefore it is appropriate that the Model Rules account for such mediation. Nevertheless, the Rule is in many ways emblematic of the current confused regulatory stance toward transactional mediators. The inclusion of transactional mediators within the Rule’s scope was apparently quite accidental.²⁰² The Committee never discussed this aspect of the Rule in any depth,²⁰³ nor debated the merits or implications of transactional mediators. In short, the Committee got lucky on this issue.

A similar lack of analysis is evident in other regulations that impact the use of transactional mediators, and the results have not always been so propitious. In this Part, I make use of the conclusions in Parts II and III and the findings in Part IV to argue for reform of such regulations. Some rules currently inhibit transactional mediator practice in areas in which it would

²⁰⁰ *Id.* (Comment 1) (emphasis added).

²⁰¹ See Douglas H. Yarn, *Lawyer Ethics in ADR and the Recommendations of Ethics 2000 to Revise the Model Rules of Professional Conduct Considerations for Adoption and State Application*, 54 ARK. L. REV. 207, 229–30 (2001) (reviewing the Committee’s work and asserting, as a Committee member, that “[b]y including the resolution of ‘other matters’ as an appropriate subject for [mediator] assistance in its recommendation, the Commission impliedly adopted a broader concept of ADR to include non-justiciable disputes as well as legal disputes and transactional as well as disputational settings.”).

²⁰² It is not clear where this language in the Comment originated. See Telephone Interview with Nancy J. Moore, *Ethics 2000 Reporter* (June 20, 2002). Most likely the language was borrowed from a proposed rule submitted to the Ethics 2000 Reporter by Professor Menkel-Meadow. Although the Menkel-Meadow draft rule did not survive, it similarly covered transactional mediation. The Preamble of that draft rule stated that the rule should apply “to the lawyer who acts as a mediator third-party, such as a mediator, arbitrator, conciliator or evaluator, to assist represented or unrepresented parties resolve disputes or arrange transactions among each other.” See CPR-Georgetown Comm. on Ethics and Standards in ADR, Preamble to Proposed New Model Rule of Prof’l Conduct, Rule 4.5 for the Lawyer Mediator (February 1999).

²⁰³ The minutes of the Ethics 2000 Committee show no extensive discussion of this aspect of Rule 2.4. Although the transactional language appeared in the initial Comments to the new Rule 2.4, the text of the rule was dispute oriented. The minutes of the Ethics 2000 Commission’s September 15–17, 2000 meeting in Philadelphia show some conversation in which a member noted that the Rule’s Comments were inconsistent with the language in the black letter rule. See *Ethics 2000 Commission Minutes* (September 15–17, 2000), at <http://www.abanet.org/cpr/e2k-09-15mtg.html> (last visited Sept. 25, 2003). The rule was then conformed to the Comment, and the “or other matter” text appeared in the November, 2000 public discussion draft of the Rule.

make sense. Section A first argues that most existing state statutes granting a privilege to mediation-related communications do not cover transactional mediation. Similarly, the proposed Uniform Mediation Act does not seem to apply to transactional mediation. This could serve as a barrier to the use of transactional mediators in almost any context, and should be reformed. In addition, Section A reviews the ways in which the broker-dealer registration requirements in the securities regulations might inhibit the use of transactional mediators in mergers and acquisitions. As Part III indicated, M&A is characterized by complex contracting in situations that could easily become strategic. As a result, it is ripe for transactional mediator intervention. I therefore argue that this area similarly requires reform.

Finally, Section B considers implications for practitioners. It focuses on various practical barriers that may prevent dealmakers from looking to transactional mediators, and suggests ways to overcome such barriers. I conclude by considering whether lawyers should be obligated to discuss transactional mediation with contracting clients.

A. Regulatory Implications

1. Mediation Confidentiality Statutes

There is certainly debate over whether information communicated during a mediation should be privileged from future discovery. Although parties can obviously contract with a mediator to keep information confidential, such contracts cannot shield the mediator from being forced to testify or divulge information if later subpoenaed. Many have argued that without a statutory privilege, parties will neither use mediation nor communicate openly to a mediator during mediation.²⁰⁴ Others have questioned this claim, attacking mediation privileges as designed to seal mediators from suit or critique.²⁰⁵

²⁰⁴ See Ellen E. Deason, *Predictable Mediation Confidentiality in the U.S. Federal System*, 17 OHIO ST. J. ON DISP. RESOL. 239, 247 (2002) [hereinafter Deason, *Predictable Mediation Confidentiality*] (noting that confidentiality is “crucial” for mediation); Ellen E. Deason, *The Quest for Uniformity in Mediation Confidentiality: Foolish Consistency or Crucial Predictability?*, 85 MARQ. L. REV. 79, 82 (2001) (arguing that confidentiality may be a “precondition for any discussion” in some disputes and that it reduces the “chilling potential of disclosures”); Edward F. Sherman, *Confidentiality in ADR Proceedings: Policy Issues Arising from the Texas Experience*, 38 S. TEX. L. REV. 541, 543 (1997) (noting that “the independence of the third-party neutral may be undermined if she were required to testify at some future time about what was said at the ADR proceeding”); see also *NLRB v. Macaluso*, 618 F.2d 51, 56 (9th Cir. 1980) (arguing that the “complete exclusion of mediator testimony is necessary” to further mediation); *Folb v. Motion Picture Indus. Pension & Health Plans*, 16 F. Supp. 2d 1164, 1172 (C.D. Cal. 1998) (arguing that “[r]efusing to establish a privilege to protect confidential

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Without entering this debate in depth, I generally believe that a mediation privilege is necessary to ensure that a party feels secure that information disclosed in confidence to a mediator will not later be discovered by the other party or an outsider. In the litigation context, parties may otherwise fear that such information will be used against them in court if the mediation fails to produce a settlement. In transactions, both parties may fear future litigation (by the other side, shareholders, or competitors) and may thus be similarly reluctant to disclose openly to a mediator. This will dampen information exchange and may prevent the parties from reaching the best deal possible.

Assuming that a privilege is justified and valuable, could transactional mediators avail themselves of existing or proposed mediation privilege statutes? Put differently, if two transacting parties were considering hiring a mediator to facilitate their contract, could that mediator guarantee them that mediated communications could be kept confidential in the face of future discovery attempts?

Others have documented the bewildering variety of state and federal approaches to shielding mediation communications from future discovery.²⁰⁶ Many states have no statute governing mediation confidentiality. Of the states that have enacted regulations, some have a comprehensive statute protecting all types of mediations, while others grant confidentiality only to designated mediation programs such as family or small-claims mediation. This makes it difficult for parties or mediators to predict whether their communications will be subject to future discovery, and thus presents a barrier to adopting mediation.²⁰⁷

Without reviewing all of the varied state statutory frameworks in this area—something that is both beyond the scope of this Article and without

communications in mediation proceedings creates an incentive for participants to withhold sensitive information in mediation or refuse to participate at all”).

²⁰⁵ See Eric D. Green, *A Heretical View of the Mediation Privilege*, 2 OHIO ST. J. ON DISP. RESOL. 1, 2 (1986) (arguing that “a blanket mediation privilege rests on faulty logic, inadequate data, and short-sighted professional self-interest”); Scott H. Hughes, *The Uniform Mediation Act: To the Spoiled Go the Privileges*, 85 MARQ. L. REV. 9, 72 (2001) (arguing that a broad confidentiality privilege can undermine the principle of self-determination by limiting the information available to the parties and by concealing a mediator’s negligence); J. Brad Reich, *A Call for Intellectual Honesty: A Response to the Uniform Mediation Act’s Privilege Against Disclosure*, 2001 J. DISP. RESOL. 197, 198–99 (2001) (arguing against the need for a privilege).

²⁰⁶ See 3 SARAH R. COLE ET AL., *MEDIATION: LAW, POLICY, PRACTICE passim* (2d ed. 1994) (reviewing state laws).

²⁰⁷ See Deason, *Predictable Mediation Confidentiality*, *supra* note 204, at 247 (“Current law is a long way from permitting parties to anticipate, even roughly, the degree of confidentiality they can count on in mediation.”).

purpose, given existing reviews in the literature—this section briefly examines existing state regulations and the newly-adopted Uniform Mediation Act (UMA) from the perspective of transactional mediators. It argues that neither most existing regulations nor the new UMA extend sufficiently clear confidentiality protections to transactional mediation to foster mediator intervention in deals.²⁰⁸ As a result, this regulatory regime may inhibit the development of transactional mediators.

a. *Existing State Mediation Statutes*

Roughly half of the states have some sort of mediation statute or regulation addressing confidentiality protections. Of those, the majority only provides confidentiality in specified mediation contexts such as family disputes, labor-management litigation, or community dispute resolution centers.²⁰⁹ In no case would these context-specific provisions offer confidentiality protection for a transactional mediation.

In those states that have passed a general mediation confidentiality statute, there is obviously a greater chance that transactional mediation might be protected. Unfortunately, however, even those states with broad mediation statutes generally employ language limiting protected mediations to those resolving litigation. Connecticut, for example, defines mediation as a process “in which a person not affiliated with either party to a lawsuit facilitates communications between such parties.”²¹⁰ Texas similarly provides confidentiality for communications made in any “alternative dispute resolution procedure,”²¹¹ but limits its privilege to those portions of a mediation related to a civil or criminal dispute.²¹²

²⁰⁸ Similarly, evidentiary protections, such as Rule 408 of the Federal Rules of Evidence, do not extend to non-litigation contexts. Rule 408 provides that

evidence of (1) furnishing or offering or promising to furnish, or (2) accepting or promising to accept, a valuable consideration in compromising or attempting to compromise a claim which was disputed as to either validity or amount, is not admissible to prove liability or for invalidity of the claim or its amount. Evidence of conduct or statements made in compromise negotiations is likewise not admissible.”

FED. R. EVID. 408.

²⁰⁹ See, e.g., ARIZ. REV. STAT. § 25-381.16 (2000) (mediation in marital and domestic proceedings); ARK. CODE ANN. § 11-2-204 (Michie 1996) (mediation in labor context); DEL. CODE ANN. tit. 11, § 9503 (2001) (victim-offender mediation); FLA. STAT. § 44.201 (2001) (community dispute settlement centers); IND. CODE § 20-7.5-1-13 (1995 & Supp. 2002) (collective bargaining in education); see also 1 COLE ET AL., *supra* note 206, § 9:12 & 3 app. A (reviewing state mediation statutes).

²¹⁰ See CONN. GEN. STAT. § 52-235d (Supp. 2003).

²¹¹ TEX. CIV. PRAC. & REM. CODE ANN. § 154.073(a) (Vernon 1997 & Supp.2003).

²¹² *Id.*; see also 3 COLE ET AL., *supra* note 206, § 9:12 (discussing statute).

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A few existing state statutes *are* potentially broad enough to cover transactional mediation. Utah extends privilege to “any information obtained in the course of an ADR proceeding” without defining “ADR proceeding.”²¹³ This leaves open the possibility of a broad interpretation. Other statutes are less clear, but could potentially be used by a transactional mediator. Wyoming, for example, defines mediation as “a process in which an impartial third person facilitates communication between two (2) or more parties in conflict to promote reconciliation, settlement, compromise or understanding.”²¹⁴ The same statute defines a mediator as “an impartial third person not involved in the conflict, dispute *or situation* who engages in mediation.”²¹⁵ This seems broad enough to cover transactions. Similarly, Virginia defines mediation as “a process in which a mediator assists and facilitates two or more parties to a controversy in reaching a mutually acceptable resolution of the controversy.”²¹⁶ The word “controversy” could be interpreted more broadly than “dispute,” particularly given that these statutes seem focused on party self-determination.²¹⁷

As a general matter, however, a transactional mediator working under existing law would have an uphill battle to squeeze such mediation within the various statutory grants of confidentiality protection. Both parties and the mediator would face a great deal of uncertainty about whether their communications would in fact be privileged. This uncertainty might deter potential parties and mediators from attempting to use a mediator in a transaction.

b. *The Uniform Mediation Act*

The National Conference of Commissioners on Uniform State Laws and a committee of the ABA Section of Dispute Resolution have recently completed drafting the Uniform Mediation Act, which is beginning to percolate to the states for adoption.²¹⁸ The UMA project was initiated to

²¹³ UTAH CODE ANN. § 78-31b-8(4) (2002).

²¹⁴ WYO. STAT. ANN. § 1-43-101(ii) (Michie 2003).

²¹⁵ WYO. STAT. ANN. § 1-43-101(iii) (Michie 2003) (emphasis added). The statute similarly defines a “party to a mediation” as “a person who is involved in the conflict, dispute or situation.” WYO. STAT. ANN. § 1-43-101(iv) (Michie 2003).

²¹⁶ VA. CODE ANN. § 8.01-581.21 (Michie 2000).

²¹⁷ Minnesota takes a similar approach. *See* MINN. STAT. § 595.02(1a) (2000) (making communication “pursuant to an . . . agreement to mediate” confidential). Section 572.33(3) defines an “agreement to mediate” as “a written agreement which identifies a controversy between the parties to the agreement.” MINN. STAT. § 572.33(3) (2000).

²¹⁸ The Act was approved by the National Conference of Commissioners on Uniform State Laws in August 2001 and by the American Bar Association in February

bring coherence to the various ways in which states have chosen to regulate mediation.²¹⁹

It is unclear whether transactional mediation falls within the scope of the UMA. The final Act defines mediation as “a process in which a mediator facilitates communication and negotiation between parties to assist them in reaching a voluntary agreement regarding their dispute.”²²⁰ Although this suggests that the Act’s protections are limited to “disputes,” the UMA does not define “dispute,” leaving unclear whether the Act could be interpreted so broadly as to include the work of a mediator in a transaction (where the mediator was helping the parties to overcome their disagreements, but was not involved in formal litigation in any sense).

The Act’s scope provision is similarly confusing. The Act can be triggered in three ways: if a dispute is referred to mediation by a court, agency, or arbitrator²²¹; if “the mediation parties and the mediator agree to mediate in a record that demonstrates an expectation that mediation communications will be privileged against disclosure”²²²; or if “the mediation parties use as a mediator an individual who holds himself or herself out as a mediator or the mediation is provided by a person that holds itself out as providing mediation.”²²³ The two latter provisions suggest that parties can opt in to the Act’s provisions either through explicit contract or by hiring a person who self-identifies as a mediator. The Reporter’s Notes indicate that the Act is meant to be “broad in its coverage of mediation,”²²⁴ and that the “central operating principle” governing scope is the honoring of the parties’ reasonable expectations about whether their interaction is covered by the Act.²²⁵ Nevertheless, these scope provisions rely upon the Act’s foundational definition of “mediation.” Put differently, they apply only to “mediations” under the Act’s definition, which is, again, based on the word “dispute.”²²⁶

2002. As of Summer 2002, the UMA had been introduced in legislation in New York, Nebraska, Oklahoma, South Carolina, and Vermont. *See* <http://www.nccusl.org/nccusl/pubndrafts.asp> (last visited Sept. 29, 2003).

²¹⁹ The UMA provides both parties and mediators with a privilege to refuse to disclose mediation communications in civil or administrative proceedings. *See* UNIF. MEDIATION ACT § 4 (2003).

²²⁰ UNIF. MEDIATION ACT § 2(1) (2003).

²²¹ UNIF. MEDIATION ACT § 3(a)(1) (2003) (describing the scope of the Act).

²²² UNIF. MEDIATION ACT § 3(A)(2) (2003).

²²³ UNIF. MEDIATION ACT § 3(A)(3) (2003).

²²⁴ UNIF. MEDIATION ACT § 3, reporter’s note 1 (2003).

²²⁵ *Id.*

²²⁶ It seems that the drafters’ understanding is that the UMA would not apply to mediators assisting with a transaction. Discussions with Richard Reuben, Reporter of the

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Extending the UMA to transactional mediators would thus depend upon a broad reading of the word “dispute” in the Act’s definition of mediation. What is a dispute? A narrow interpretation would limit “disputes” to litigation—those disputes involving contested legal rights or part of a formal adjudicative process. A broad interpretation would incorporate all disagreements or differences of opinion. Black’s Law Dictionary illustrates the definitional problem. On the one hand, Black’s defines “dispute” broadly as a “conflict or controversy; a conflict of claims or rights; an assertion of a right, claim, or demand on one side, met by contrary claims or allegations on the other.” On the other hand, Black also lists a more narrow, litigation-focused definition: dispute as “[t]he subject of litigation; the matter for which a suit is brought and upon which issue is joined, and in relation to which jurors are called and witnesses examined.”²²⁷

It seems most likely that were a transactional mediator to claim privilege under the UMA, a court would interpret the Act’s use of the word “dispute” narrowly to deny the privilege in this circumstance. First, the Act grew out of the Alternative Dispute Resolution movement, which has traditionally focused on settling litigation.²²⁸ As discussed above, few have considered the possibility of using mediators in transactions.²²⁹ There is certainly no consensus on a definition of “mediation,” but almost all such definitions incorporate the use of the word “dispute.”²³⁰ Given that the authors of such

ABA Section of Dispute Resolution Drafting Committee in Cambridge, Mass. (Jan., 2000); Telephone Interview (July, 2002).

²²⁷ BLACK’S LAW DICTIONARY 424 (5th ed. 1979).

²²⁸ See Douglas H. Yarn, *Lawyer Ethics in ADR and the Recommendations of Ethics 2000 to Revise the Model Rules of Professional Conduct: Considerations for Adoption and State Application*, 54 ARK. L. REV. 207, 217–18 (2001) (“Dispute in the context of using an alternative to litigation [as in ADR] implies a conflict that could be framed as a legal dispute, meaning a dispute involving rights that could be granted or denied by a court.”).

²²⁹ See *supra* notes 11–16 and accompanying text.

²³⁰ Many definitions of mediation contain the words “dispute” or “disputants.” See JOHN W. COOLEY, *THE MEDIATOR’S HANDBOOK* 1–2 (2000) (defining mediation as a “process for resolving conflict” and as “a process in which a disinterested third party . . . assists the disputants in reaching a voluntary settlement of their differences through an agreement that defines their future behavior”); Kenneth Kressel, *Mediation*, in *THE HANDBOOK OF CONFLICT RESOLUTION: THEORY AND PRACTICE* 522, 522 (Morton Deutsch & Peter T. Coleman eds., 2000) (“Mediation may be defined as a process in which disputants attempt to resolve their differences with the assistance of an acceptable third party.”); Am. Arbitration Ass’n, *Definitions—Introduction to the Terminology of Dispute Avoidance and Resolution*, 1998, at 1 (defining “mediation” as “[a] process that calls for parties to work together with the aid of a mediator facilitator who assists them in reaching a settlement. The mediator’s role is advisory and resolution of the dispute rests with the parties themselves”).

definitions then discuss mediation as a form of litigation settlement, it is a stretch to claim that in the ADR field “dispute” actually signifies “litigation and transactions.”

Second, although its definitions are broad, the UMA is primarily concerned with the use of mediation as an alternative to litigation. Various other provisions address concerns specifically related to the settlement of litigation; none address transactional mediation.²³¹ This suggests that the Act was designed to cover only the former.

Third, had the UMA’s drafters wanted to extend the Act to cover transactional mediation, they could easily have followed the lead set by the drafters of the new Model Rules of Professional Conduct and included the word “transactions” in their definitional section.²³² Given that the definition in the proposed Model Rule 2.4 was available to the UMA’s drafting committee, a court might infer that the UMA’s drafters did not want to extend the privilege to transactional interventions.

Fourth, courts interpreting contractual agreements to arbitrate all “disputes” have often assumed that the word refers to claims that could be litigated. That the parties have a bona fide disagreement may not mean that they have a “dispute” in the legal sense.²³³ Courts have held that whether a dispute exists turns on whether a matter of fact or law has been asserted by

²³¹ See, e.g., UNIF. MEDIATION ACT § 7(a) (2003) (“[A] mediator may not make a report, assessment, evaluation, recommendation, finding, or other communication regarding a mediation to a court, administrative agency, or other authority that may make a ruling on the dispute that is the subject of the mediation.”).

²³² See *supra* notes 200–01 and accompanying text. Alternately, the UMA could have incorporated a word more broad than “dispute” without referencing transactions. “Differences,” for example, is more broad, incorporating within it almost any type of disagreement or dispute. See, e.g., *Int’l Union of Operating Eng’rs v. Flair Builders, Inc.*, 406 U.S. 487, 491 (1972) (holding that the term “any difference” in an arbitration agreement was broad and covered all types of disputes). This might, however, open the doors to the UMA too widely.

²³³ Felstiner, Abel, and Sarat’s essay on the emergence of disputes similarly suggests that although the word “disputing” refers to the entire process of grievance formation, the word “dispute” refers to the end stages of the transformation of a simple disagreement into litigation. See William L.F. Felstiner et al., *The Emergence and Transformation of Disputes: Naming, Blaming, Claiming . . .*, 15 LAW & SOC’Y REV. 631, 635–36 (1981) (discussing progression through naming, blaming and claiming stages as a dispute evolves).

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one side and denied by the other.²³⁴ At least one court has held that a mere assertion of rights is not a “dispute” in this sense.²³⁵

Although one must refer to such arbitration cases by analogy, they suggest that in the ADR context courts have interpreted the word “dispute” to refer to litigated disagreements or to differences that present an issue that could be legitimately litigated. Two parties in a transaction that hire a mediator to facilitate their negotiations and to help them reach a more value-creating solution might have difficulty meeting this standard. This suggests, again, that the UMA would not shield transactional mediators.

If this interpretation is correct, the broad adoption of the UMA by the states in the coming years could be a significant constraint on the possibility of using transactional mediators. Although most current state law seems to accord with the UMA in excluding transactional mediators from mediator confidentiality statutes,²³⁶ the UMA would narrow those existing laws that *might* protect transactional mediation. Moreover, it would solidify the assumption that mediation exists solely in the litigation domain. Even if this interpretation of the UMA is incorrect, it raises sufficient doubts to deter transacting parties from using a mediator. Uncertainty about the UMA’s

²³⁴ See *Cox v. Fremont County Pub. Bldg. Auth.*, 415 F.2d 882, 886 (10th Cir. 1969) (citing *Gold Uranium Mining Co. v. Chain O’Mines Operators*, 262 P.2d 927 (Colo. 1953)).

²³⁵ See *Weinstock v. Weinstock*, 240 A.D.2d 658, 658 (N.Y. 2d. 1997) (involving a wife that asserted a claim for support and a husband that did not claim that he owed support, and finding that there was no “dispute” under the arbitration clause and that she was not required to arbitrate her claims and could instead bring them to court for enforcement). Put differently, a court may decide as a matter of law that the parties’ disagreement does not rise to the level of a “dispute” within the contract’s arbitration clause. For example, in *Hausner v. Hopewell Prods. Inc.*, 187 N.Y.S.2d 406 (N.Y. Sup. Ct. 1959), three partners established several stock corporations. Their agreement dictated that in the event that one partner wanted to retire from the business, he would tender his shares to the others. It also provided that in the event of a tender, the retiring director would resign as a corporate officer and be discharged from all corporate duties. All “disputes” were subject to arbitration. Litigation arose when one director offered to sell his shares to his partners and they rejected his offer. They then insisted that he nevertheless resign as an officer, interpreting “tender” to include rejected offers. He disagreed, arguing that a tender occurred only if accepted. The court held that, although “[u]ndoubtedly a difference of opinion exists between the parties as to the meaning of the word ‘tender’ in the agreement,” there was no need to send that disagreement to arbitration. *Id.* at 408. According to the court, it would violate common sense and logic to construe “tender” in this fashion. Therefore, the court held that “[t]here is no such dispute existing in this regard which would justify permitting an arbitration board to pass upon th[e] interpretive] question.” *Id.*

²³⁶ See *supra* notes 210–18 and accompanying text.

scope means that a mediator cannot guarantee the parties that their communications will be kept confidential.

To reduce such uncertainty, states should modify their existing statutes or their adoption of the Uniform Mediation Act to account for transactional mediators. The most simple and uniform modification would borrow language from the new Model Rules of Professional Conduct Rule 2.4. Rather than adopting the UMA's definition of mediation as "a process in which a mediator facilitates communication and negotiation between parties to assist them in reaching a voluntary agreement regarding their dispute,"²³⁷ the states could simply replace "dispute" with "dispute or other matter," per Rule 2.4's approach. Like the new Rule 2.4, the comments to the state's mediation privilege statute could then clarify that "other matter" included transactional mediation.²³⁸

2. Securities Regulations

In addition to uncertainties about privilege, a mediator seeking to intervene in transactions faces uncertainties about certain substantive areas of the law. This section explores whether a mediator intervening in the mergers and acquisitions context would be required to register as a broker or investment adviser under the securities laws, and the consequences of uncertainty regarding this issue.

a. Broker-Dealer Registration Requirements

Under section 3(a)(4) of the Securities Exchange Act of 1934, a "broker" is "any person engaged in the business of effecting transactions in securities for the account of others."²³⁹ Although on its face the use of the word "effecting" suggests that only agents with authority to close a transaction would be implicated, the SEC has adopted a broad interpretation of "effecting transactions."²⁴⁰ Unfortunately, the SEC's approach to the question of who must register as a broker has been neither uniform nor entirely clear. In the typical brokerage situation in which a broker trades on a customer's account, the issue is simple. Regulation is required to protect confidence in the securities exchanges and the investment vehicle and to

²³⁷ UNIF. MEDIATION ACT §2(1) (2003).

²³⁸ See *supra* note 198 and accompanying text (describing the Model Rule 2.4 approach).

²³⁹ 15 U.S.C. § 78c(a)(4) (2000).

²⁴⁰ See John Polanin, Jr., *The "Finder's" Exception From Federal Broker-Dealer Registration*, 40 CATH. U. L. REV. 787, 794 (1991).

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prevent brokers from misusing client funds. In atypical situations, however, in which an agent-intermediary participates in securities-related activities (such as some mergers) but is not necessarily trading or “effecting transactions” per se, the section 3(a)(4) test becomes more difficult to apply. The SEC has provided little guidance on the scope of 3(a)(4), and little academic commentary has focused on the issue in the merger context.

As a general proposition, the SEC has held that if a distribution or exchange of securities takes place, an agent-intermediary receives a percentage commission, or the intermediary is involved in the parties’ negotiations, the intermediary must be registered as a broker-dealer.²⁴¹ The intermediary need not have *authority* to close the transaction to be considered a broker. The key factor seems to be whether the agent plays a significant role in negotiating and closing the transaction, including whether the agent offers advice on valuation or strategy.²⁴²

This focus on negotiations, of course, might implicate a mediator. Given that a mediator would be intimately involved in the negotiation and closing of a merger or acquisition, that mediator’s services might fall within the scope of 3(a)(4).

To remove themselves from the SEC’s reach, mediators could argue that a mediator does not fall within 3(a)(4) because a mediator does not have fiduciary duties to either party. A mediator could try to analogize its services to the SEC’s historical exception for those intermediaries who serve merely as finders in transactions.²⁴³ A broker is a fiduciary agent with duties that extend beyond the matching stage.²⁴⁴ A finder, by contrast, merely introduces the parties and then exits, leaving the negotiations to others. Because the finder’s limited role affords few opportunities to impact sale price or terms, the SEC has traditionally exempted finders from registration. Although the line can be difficult to draw, the SEC has made clear that a

²⁴¹ See International Business Exchange Corp., SEC No-Action Letter, 1986 SEC No-Act. LEXIS 3065, at *5 (Dec. 12, 1986) (“[A] professional who brings together potential buyers and sellers and advises the parties on questions of value, plays an integral role in negotiating the transaction, or provides other services designed to facilitate the transaction, may be deemed to be a broker.”); Wesco Equity Funding, SEC No-Action Letter, 1985 SEC No-Act. LEXIS 2634, at *2–*3 (Aug. 10, 1985) (same).

²⁴² See Fulham & Co., SEC No-Action Letter, 1972 SEC No-Act. LEXIS 4488, at *2 (Dec. 20, 1972) (stressing the company’s “proposed participation in negotiations with respect to merger transactions” in requiring registration).

²⁴³ See Polanin, *supra* note 240, at 816–18 (reviewing SEC no-action letters).

²⁴⁴ Compare *Burleson v. Earnest*, 153 S.W.2d 869, 873–74 (Tex. Civ. App. 1941) (holding that real estate broker had fiduciary obligations and was not a mere “middleman” or finder), with *Williams v. Kinsey*, 169 P.2d 487, 493 (Cal. Ct. App. 1946) (finding that broker was merely a middleman who owed no duties beyond matching the parties).

finder that serves *solely* to match parties need not register. In *Venture Capital Network, Inc.*,²⁴⁵ for example, the SEC exempted a computer-driven matching service, emphasizing that the service did not provide any assistance to the parties after making the introductory match. In other words, a finder may bring the parties to the point of an initial handshake but no further.²⁴⁶

²⁴⁵ *Venture Capital Network, Inc.*, SEC No-Action Letter, 1984 SEC No-Act. LEXIS 1501, at *1-*2 (May 7, 1984).

²⁴⁶ When confronted with the parallel problem of distinguishing between finders and brokers in real estate and small business transactions, state courts have consistently focused on whether a finder participates in negotiations subsequent to introducing the parties and on whether the principal granted the finder any authority to close the deal. *See* 12 AM. JUR. 2d *Brokers* § 208 (1997):

In order to be regarded as a mere middleman . . . the broker must not be invested with the least discretion, and the . . . employer must have no right to rely on obtaining the benefit of the broker's judgment. If the broker takes, or contracts to take, any part in the negotiations, the broker cannot be regarded as a mere middleman, no matter how slight a part it may be."

The rationale is that a finder who merely introduces parties need not be as knowledgeable about the transaction as a broker who engages in negotiations. *See, e.g.*, *Tyrone v. Kelley*, 507 P.2d 65, 72 (Cal. 1973) ("One who merely introduces two parties to a real estate transaction, whether or not he solicits those persons, does not need to be as knowledgeable about real estate transactions as a licensed broker, unless, of course, he participates in the negotiations."). Titles, however, do little to clarify the confusion. As the courts have noted, "the dispositive issue of fiduciary-like duty or no such duty is determined not by the nomenclature 'finder' or 'broker' or even 'agent,' but instead by the services agreed to under the contract between the parties." *Northeast Gen. Corp. v. Wellington Adv.*, 624 N.E.2d 129, 132 (N.Y. 1993). To avoid the definitional problem, some courts have held that under some state real estate licensing statutes all finders are in fact brokers. In *Wickersham v. Harris*, 313 F.2d 468 (10th Cir. 1963), for example, the Tenth Circuit found that the District of Columbia's real estate statute included finders within the definition of broker, despite the fact that courts interpreting California's nearly identical provision had found a distinction between the two roles. *See id.* at 471-72; *see also* *George Nangen & Co. v. Kenosha Auto Transp. Corp.*, 238 F.Supp. 157, 159 (E.D. Wisc. 1965) (finder of a buyer for a business was a "real estate broker"); *Broughall v. Black Forest Dev. Co.*, 593 P.2d 314, 315 (Colo. 1978) (finder of a buyer for a radio station was a "real estate broker"); *Baird v. Krancer*, 246 N.Y.S. 85, 88 (N.Y. Sup. Ct. 1930) (holding that finders must be brokers, else a broker could avoid the statute's reach "simply by calling himself a *finder*, an *originator*, an *introducer*, instead of a *broker*") (emphasis added); *Alford v. Raschiatore*, 63 A.2d 366, 368 (Pa. Super Ct. 1949) (bringing parties together for discussions qualifies as "negotiation of the resulting sale"); *Schmitt v. Coad*, 604 P.2d 507, 510 (Wash. Ct. App. 1979).

Although the distinction has sometimes been unclear, it is important. Many states bar recovery of fees if an intermediary is found to have acted as a real estate broker but without a license, even if the intermediary believed that he was merely serving as a finder (and thus did not require a license). The broker or finder thus stands to lose its fee for failure to be properly licensed. As a result, such regulations have an in terrorem effect.

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Recently, however, the SEC has taken a more narrow view of the so-called finder's exception. In 1985, the Commission considered a request from Dominion Resources, Inc., a financial services firm. Dominion asked whether it would be required to register as a broker if it assisted issuers of securities by analyzing their finances, recommending bond lawyers and underwriters, and introduced the issuers to commercial bankers who would act as the initial purchasers of the securities. Dominion represented that the only contact it would have with the commercial bank/purchaser was the introduction of the issuer to the bank. The SEC issued a no-action letter to Dominion, indicating that it would not take action against Dominion for not registering as a broker-dealer.²⁴⁷

The SEC revoked this opinion in March 2000.²⁴⁸ The SEC stated that since 1985, "the staff has frequently considered the question of when a person is a broker that must register . . . and when a person is merely a 'finder' that is not subject to registration More recently, the staff has denied no-action requests in situations somewhat similar to the arrangement described in the Dominion Resources . . . 1985 no-action letter."²⁴⁹ More generally, the SEC recently seems inclined to reach farther in its regulation of brokerage and M&A activity.²⁵⁰

Given this narrowing of the "finder's exception," there is no obvious doctrinal safe harbor for a mediator. In arguing against application of the broker registration requirements, therefore, a mediator would have to contend that mediators pose no risk about which the SEC should be concerned.²⁵¹

Matchmakers are reluctant to engage in any kind of negotiation—and will push principals to handle negotiations themselves—in order to avoid any appearance of engaging in regulated activity. *See* REED & LAJOUX, *supra* note 92, at 51 ("[I]t is extremely important that the finder or broker not perform any act that a court could consider to be negotiation, and make sure that the principals do all the negotiating and acknowledge it in writing.").

²⁴⁷ Dominion Resources, Inc., SEC No-Action Letter, 1985 SEC No-Act. LEXIS 2511, at *8 (Aug. 22, 1985).

²⁴⁸ Dominion Resources, Inc., SEC Revocation Letter, 2000 SEC No-Act. LEXIS 304, at *4 (Mar. 7, 2000).

²⁴⁹ *Id.* at 3.

²⁵⁰ *See* 1st Global, Inc., SEC No-Action Letter, 2001 SEC No-Act. LEXIS 557, at *8 (May 7, 2001) (partially denying no-action relief to a broker seeking to pay commissions to certified public accountants); John R. Wirthlin, SEC No-Action Letter, 1999 SEC No-Act. LEXIS 83 at *2-*3 (Jan. 19, 1999) (denying no-action relief to a finder who proposed to contact tax accountants and other professionals whose clients might be interested in investing in a real estate limited partnership).

²⁵¹ *See* David A. Lipton, *A Primer on Broker-Dealer Registration*, 36 CATH. U. L. REV. 899, 900 (1987) (arguing that the test for registration should be whether the activity will "create risks comparable to those arising from the activities of customary broker-dealers").

The broker-dealer registration requirements were created to protect the public and the securities markets. The underlying rationale is that brokers and other intermediaries giving advice regarding major transactions can inflate prices, misuse funds, or otherwise undermine the securities markets, and therefore must be regulated.

Does the rationale extend to transactional mediators? On the one hand, it seems strange to require a mediator to register as a broker and be regulated as a broker given that the mediator is not actually going to engage in “brokerage” in the traditional sense. The mediator will broker the deal, but not as a partisan agent. A mediator is not tainted by the incentive problems that might affect a traditional broker,²⁵² nor does a non-binding mediator have any authority to force transacting parties to structure their deal in a particular way.

On the other hand, a mediator in a major merger would certainly be in a position to impact the transaction. In fact, a mediator might have *more* ability than a partisan broker to influence the overall structure of the deal. A mediator might help parties structure legal terms, allocate risk, and manage due diligence. She might mediate emotional issues and help to find value-creating trades. In some cases she might be used to resolve disagreements about price. In addition, although a mediator might not take a percentage-based fee, she would have reputational and other personal incentives to try to close the deal. Mediators are not perfect, and inevitably mediators might try to influence securities-related transactions to serve their own interests.²⁵³ To the extent that the SEC has a role to play in regulating negotiations involving major securities transactions, it therefore seems likely that it might seek to extend 3(a)(4) to mediators.²⁵⁴

²⁵² For a general discussion of fee structures in dispute mediation, see Peppet, *supra* note 124.

²⁵³ See *supra* notes 124–25 and accompanying text (discussing the agency and incentive problems presented by introducing a mediator).

²⁵⁴ Another question is whether a *lawyer*-mediator would be required to register. Currently lawyers and accountants are excepted from the broker-dealer registration requirements. The source of that exception is a 1980 SEC no action letter. Garrett Kushell Associates, SEC No Action Letter, 1980 SEC No-Act. LEXIS 3744, at *1–*2 (Sept. 7, 1980). That no action letter addressed a real estate broker’s concern about registration. Although the underlying facts did not involve an attorney, the SEC’s letter stated that “persons (other than professionals such as lawyers or accountants acting *as such*) who play an integral role in negotiations and effecting mergers or acquisitions . . . are required to register as broker-dealers.” *Id.* (emphasis added). The question therefore turns on whether a lawyer-mediator is acting as a lawyer in the sense that the SEC requires to fall within this exception. Although whether mediation constitutes the practice of law has been a much-debated topic, the new Model Rule 2.4 makes clear that parties to a mediation should not consider a lawyer-mediator to be their attorney. See Joshua R.

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b. *The Investment Advisers Act*

In addition to the broker-dealer registration requirements, a mediator might fall within the provisions of the Investment Advisers Act of 1940.²⁵⁵ Under that Act, an investment adviser is “any person who, for compensation, engages in the business of advising others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities.”²⁵⁶ As with the broker-dealer registration requirements, applying this provision to mediators is a bit of a stretch. Although some mediators might give advice or recommendations regarding the value of securities or “as to the advisability of purchasing” securities, many—particularly those focused more on the relational aspects of a transaction—might not. Part II concludes that mediators are more likely to be of value in the closing stages of a merger or acquisition, not during the pricing stage. Nevertheless, it is conceivable that some mediators could engage in regulated activities under the Act. (Intriguingly, one of the respondents to my survey indicated that he was a registered investment advisor and that this gave him a competitive advantage in transactional mediation.) Such mediators would thus be required to register with the SEC.

c. *Consequences of Confusion*

Regulation as either a broker or an investment adviser could have serious consequences for a transactional mediator. Brokers must register with the NASD on Form BD, which involves disclosure of corporate and financial information.²⁵⁷ A registered broker must meet certain record-keeping and minimum asset requirements. Similarly, the Investment Advisers Act imposes a duty to disclose potential conflicts of interest, including all fees

Schwartz, Note, *Laymen Cannot Lawyer, But Is Mediation The Practice Of Law?*, 20 CARDOZO L. REV. 1715 (1999); Carrie Menkel-Meadow, *Ethics and Professionalism in Non-Adversarial Lawyering*, 27 FLA. ST. U. L. REV. 153, 156 n.19 (1999) (providing citations); see also Model Rules of Prof'l Conduct, R. 2.4(b) (2002) (“A lawyer serving as a third-party neutral shall inform unrepresented parties that the lawyer is not representing them.”). Assuming this view to be correct, the SEC is unlikely to except lawyer-mediators from the registration requirement. Instead, a lawyer serving as a mediator in the closing stage of a merger or acquisition involving the sale of securities would likely find herself just as subject to the SEC’s requirements as any other mediator.

²⁵⁵ See 15 U.S.C. § 80b-3 (2000 & Supp. 2003).

²⁵⁶ 15 U.S.C. § 80b-2(a)(11) (2000 & Supp. 2003).

²⁵⁷ See 17 C.F.R. § 249.501(a) (2003). Section 15(a) of the Securities Exchange Act requires financial disclosure. 15 U.S.C. 78o(a) (2000); see also 15 U.S.C. § 15(b)(7) (requiring that broker-dealers comply with SEC’s financial conditions regarding solvency).

and fee arrangements; regulates advertising and an adviser's performance claims; requires record-keeping of personal securities transactions; and controls referral arrangements. These provisions could present barriers to entry for mediators.

At the very least, the SEC should take transactional mediators into account and issue clear guidelines for their practice in the M&A context. I would argue that mediators should not be required to register as brokers, given that they do not serve as agents and thus that many of the broker-registration requirements—such as minimum asset requirements—are ill-suited to mediator practice. To extend 3(a)(4) to mediators would stretch the provision beyond reason. Similarly, not all mediators should be required to register as investment advisers. Only those that actively engage in valuing securities and making substantive recommendations on their purchase should fall within the Investment Advisers Act. At the same time, I would concede that the SEC might take an interest in mediators, particularly given that a mediator could be instrumental in the structuring and negotiation of a merger or acquisition involving securities. To truly take account of mediators, ideally a new category of regulations and requirements would be applied to their practice. Regardless of the form such regulation takes; however, *some* action is needed to reduce the uncertainty that a mediator would currently face in this regard.

B. Implications for Attorneys and Mediators: Overcoming Barriers to More Widespread Use of Transactional Mediators

This Article obviously has implications for mediators, lawyers, and transacting principals. It suggests that mediators can improve upon agent-assisted deals in some circumstances. Nevertheless, I expect that many dealmakers will resist the notion of incorporating a mediator into their transactional negotiations. This section briefly considers some of the barriers that transactional mediators likely face, and how they might be overcome. In particular, I argue that existing ethical rules that require attorneys to advise litigating clients about alternative dispute resolution should be extended to encourage—but not require—transactional lawyers to do likewise.

1. Barriers to Entry

a. Habit

The most significant barrier to entry for transactional mediators is most likely habit. Dealmakers are accustomed to contracting in a certain way, with

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certain agents. They may be reluctant to change the status quo process, particularly if the stakes are high.

b. *Optimistic Overconfidence*

Research has shown that negotiating parties tend to be overconfident in their own assessments, predictions, and abilities, and that they tend to be overly optimistic about their chances of success in their endeavors.²⁵⁸ Litigants, for example, predict their own success more often than is warranted. It is likely that transacting parties similarly assume that their deal will succeed. More importantly, perhaps, buyers and sellers seem likely to assume that they can conclude a deal and find all of the available gains from trade without mediator assistance.

As discussed above, Howard Raiffa's experiment with corporate executives demonstrated that transacting parties sometimes overlook available gains from trade.²⁵⁹ Nevertheless, when Raiffa offered these executives the use of a mediator to facilitate their bargaining, many failed to take him up on his offer. According to Raiffa, few executives in his study made use of the available mediator:

Most felt that the mediator knew nothing of the details, so they saw no advantage in complicating their problem with the inclusion of a third party; believing that their negotiating adversaries would not give truthful information to the mediator, they saw no reason why they themselves should. Those who used the mediator did "better" (in a . . . joint sense), but they were surprised to find out that they had done better—after all, everything they had done with the mediator they could have done without the mediator, or so they thought.²⁶⁰

Raiffa found that, despite their confidence, the executives who did not use the available mediator did worse than those groups that asked for a mediator. This illustrates that sophisticated parties may be sufficiently overconfident in their own abilities that they will ignore the potential benefits of mediator assistance.

Such overconfidence is likely to be even more pronounced outside of the laboratory. Businesspeople establish reputations for their negotiating prowess. Lawyers, bankers, and brokers may likewise pride themselves on

²⁵⁸ For an overview of optimistic overconfidence in negotiations, see Daniel Kahneman & Amos Tversky, *Conflict Resolution: A Cognitive Perspective*, in BARRIERS TO CONFLICT RESOLUTION 45, 46–50 (Kenneth J. Arrow et al. eds., 1995).

²⁵⁹ See *supra* notes 15 & 138 and accompanying text (describing experiment).

²⁶⁰ RAIFFA, *supra* note 15, at 102.

their ability to get a deal done and squeeze all the available value out of that deal. Such dealmakers may have great difficulty accepting that a mediator could in any way add value to their transactions.

c. *Strategic Resistance*

The choice to use a mediator is in itself a bargaining problem. To the extent that a party fears that using a mediator will result in a worse outcome for that party, the party may resist adding a mediator.²⁶¹ The parties' negotiation over whether to hire a mediator may not be as difficult to resolve as their underlying substantive differences,²⁶² but one or both may resist mediator intervention because of doubts about its strategic implications.

A contracting party may also fear that suggesting mediator intervention will in itself signal weakness. Mergers, acquisitions, and other high-stakes transactions are often carried out with a certain bravado. Successful dealmakers may worry that proposing to hire a mediator will be interpreted as an implicit admission of inability or fear. More problematic still, an opposing party might believe that the suggestion to bring in a mediator portends difficulties down the road—that the proposer is signaling that the deal is likely to be close to collapse at some point. In the transactional world, parties may go to great lengths to avoid *any* such suggestion.

d. *Agency Barriers*

In addition to the principals' reluctance to use a mediator, lawyers, bankers, brokers, and other agents that currently assist in transactions may resist mediator assistance.²⁶³ An agent may fear that if a mediator can find

²⁶¹ See generally Brown & Ayres, *supra* note 31; see also Howard Raiffa, *The Neutral Analyst: Helping Parties to Reach Better Solutions*, in NEGOTIATION: STRATEGIES FOR MUTUAL GAIN 14, 17 (Lavinia Hall ed., 1993) (describing this problem). For a general description of an analogous problem in another context, see also Stephen Craig Pirrong, *The Efficient Scope of Private Transactions-Cost-Reducing Institutions: The Successes and Failures of Commodity Exchanges*, 24 J. LEGAL STUD. 229 (1995) (examining resistance to creating Chicago Board of Trade caused by the distributive effects of implementing a new, more efficient trading system).

²⁶² See, e.g., Vincent P. Crawford, *The Role of Arbitration and the Theory of Incentives*, in GAME-THEORETIC MODELS OF BARGAINING 363, 370–71 (Alvin E. Roth ed. 1985) (arguing that parties can overcome the “choice of arbitrator” problem and that “[b]argainers might easily have better luck in agreeing on an arbitrator than in agreeing on a settlement”).

²⁶³ Some agents—particularly brokers—may fear that a mediator will reduce or eliminate their fees. Common law has traditionally held that a broker or finder must be the “procuring cause” of a transaction in order to be entitled to his commission (unless

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otherwise-overlooked value-creating trades, the agent's clients will begin to doubt the agent's skills as a negotiator. Lawyers may be particularly reluctant to allow a mediator into their negotiations, given that transactional attorneys often pride—and sell—themselves on their bargaining abilities. More generally, to the extent that a mediator can help parties to monitor their agents (and thus reduce agency costs), agents have an inherent incentive to resist the use of such mediators. Finally, a lawyer or other agent may fear that a client will turn exclusively to using a mediator, completely eliminating the agent from transactions.

e. Fear of Transaction Costs

Finally, contracting parties or their agents may fear that mediators will do little but increase transaction costs. As Raiffa's experiment suggested, transacting parties may believe that a mediator can do little for them that they cannot do for themselves.²⁶⁴ If a mediator cannot demonstrate that her services will consistently add value, it will be hard to overcome these assumptions.

For example, it is well known that negotiators tend to assume that they face a zero-sum situation rather than an opportunity with value-creating or integrative potential.²⁶⁵ One study, for example, found that 68% of negotiators assumed that there would be no opportunity to make value-creating trades.²⁶⁶ This "fixed pie bias" could preclude dealmakers from

his contract specifies otherwise). If another broker successfully intervenes to negotiate in the transaction, the first broker may not be entitled to his commission. This raises the possibility that if a mediator facilitated the closing of a deal, various brokers might have cause for concern about whether they would receive their fees. *See* *Moehling v. Brickman*, 240 N.E.2d 210, 213 (Ill. 1968) (holding that no commission is due where there is an "intervening instrumentality which may be regarded as the effective or efficient cause of the sale") (citations omitted); *Modern Tackle Co. v. Bradley Indus., Inc.*, 297 N.E.2d 688, 693 (Ill. App. Ct. 1973) (holding that finder who introduced parties was not entitled to fees because of intervening agency); *Whitcomb v. Bacon*, 49 N.E. 742, 743 (Mass. 1898) (holding that where a second broker effects the sale, only that broker recovers fees absent a contract to the contrary). Current brokerage contracts modify this common law rule, and existing agents could almost certainly deal with the problem by modifying their contracts to ensure their fees even were a mediator used to close the transaction.

²⁶⁴ *See supra* notes 15 and 138; *see also* text accompanying note 138.

²⁶⁵ *See generally* Max H. Bazerman, *Negotiator Judgment: A Critical Look at the Rationality Assumption*, 27 AM. BEHAV. SCIENTIST 211 (1983).

²⁶⁶ Leigh Thompson & Reid Hastie, *Social Perception in Negotiation*, 47 ORG. BEHAV. & HUM. DECISION PROCESSES 98, 107 (1990).

employing a mediator if a significant component of a mediator's value derives from helping the parties to optimize their deal.

In addition, parties may fear costs associated with changing their negotiation process. Contracting parties are consumers of a bargaining process. Changing that process requires overcoming various switching costs.²⁶⁷ There may be search costs in finding a mediator that one trusts and that has the expertise needed to assist. There will also be learning costs: the parties will incur costs in learning how to close deals using a mediator, as opposed to through purely face-to-face bargaining. There may also be contractual switching costs if a party has contractual obligations to continue using a given agent, broker, law firm, or investment banker and will be formally or informally penalized for changing the status quo.²⁶⁸

2. Should Transactional Lawyers Be Required to Advise Contracting Clients About Mediation?

There are no easy solutions to these problems. Like the evolution of alternative dispute resolution processes in the litigation context, it will take time to promote and tailor mediator services in transactions. Part IV showed that some demand already exists for such services, and that mediators are sometimes intervening in contract formation. To further promote the use of transactional mediators, the legal and mediation communities should consider efforts to educate parties and their lawyers, and the possibility of requiring attorneys to advise transacting clients about the potential benefits of mediators.

a. Education

In terms of education, three main points seem the most important. First, mediators, the ADR community, and the organized bar must educate both parties and their agents about the potential benefits of mediator intervention in contracting. Existing education efforts completely overlook the possibility of mediator assistance with pre-closing contract bargaining.²⁶⁹ Such efforts

²⁶⁷ See Paul Klempner, *Markets with Consumer Switching Costs*, 102 Q. J. ECON. 375, 375-77 (1987) (describing various types of switching costs).

²⁶⁸ Parties in the M&A context, for example, might fear changing the bargaining process to introduce mediators. There might be monetary or reputational sanctions for doing so. A corporation, for example, might lose most favored nation status with its bankers if it suggested that a mediator could add value that the investment bank's fee structure prevented it from capturing. The implicit criticism in switching could be taken poorly, and the existing quasi-mediator agent might punish the principal for doing so.

²⁶⁹ See, e.g., Suzanne J. Schmitz, *Giving Meaning to the Second Generation of ADR*

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must overcome this failure. Through education, mediators can try to assuage strategic fears by explaining that the process is non-binding and that the party will not be forced into anything. Similarly, mediators can try to reassure lawyers, bankers, or other agents that employing mediators—and potentially reaching a better deal for their clients—will not reflect poorly on their performance as agents. This is a difficult road, and it will not always succeed. Nevertheless, if lawyers and other agents begin to understand the benefits that a mediator can bring, they will ultimately choose to use such mediators when it will best satisfy their clients' interests.

Second, mediator services in the transactional context should be tailored to those deals in which a mediator can create the most value. This Article has made the case for transactional mediators, but the argument comes with caveats and qualifications. It will do more harm than good to the notion of transactional mediators to promote their intervention in contexts in which there is little for them to do. Mediators must therefore be trained to understand when their services will be valuable in transactions so that they do not overextend their reach.

Finally, assuming that mediators follow this advice, parties can be taught that the transaction costs added by employing a mediator are likely to be relatively minor compared to either the value of the transaction or the value that they can create. In a large merger, acquisition, or joint venture, the parties already spend huge sums on lawyers, bankers, and brokers. Given that a transactional mediator would work on a flat or hourly fee, even if that fee were extremely high, the mediator's added costs would be minor as compared to the costs imposed by these other agents. Mediators should also work to provide parties with metrics of the mediator's added value. Raiffa's "contract embellishment" procedure, for example, has the advantage that the mediator can demonstrate added value by comparing the pre-intervention contract with the mediator's improved contract. To the extent possible, mediators must work to quantify such Pareto-improvements for their clients.

b. An Ethical Requirement for Transactional Attorneys?

Whether a litigating attorney should have a duty to inform her client about the availability of alternative dispute resolution processes has been much debated.²⁷⁰ Some have argued that such a requirement is implicit in

Education: Attorneys' Duty to Learn About ADR and What They Must Learn, 1999 J. DISP. RESOL. 29, 30 (providing a "second generation" ADR primer for attorneys but not considering the use of transactional mediators).

²⁷⁰ See Marshall J. Breger, *Should an Attorney Be Required to Advise a Client of ADR Options?*, 13 GEO. J. LEGAL ETHICS 427, 462–76, app. I–III (2000) (providing extensive references to the debate and a bibliography of the topic).

existing ethics rules that obligate an attorney to keep her client informed about the status of her legal matter.²⁷¹ Others have urged more explicit provisions that require attorneys to educate clients about ADR. Some courts and bar associations have begun to implement such proposals.²⁷²

Not surprisingly, these provisions are most often litigation-focused. Without conducting an exhaustive survey here, even a quick review indicates that these provisions generally require an attorney to certify that she has made such ADR-related disclosures prior to filing court papers, or they are worded to apply only to litigation.²⁷³ The question, therefore, is whether such provisions should be extended to corporate and transactional attorneys working with dealmaking clients.

Complete analysis of this question is obviously beyond the scope of this Article. In short, however, I believe that it would be appropriate for state courts and bar associations to adopt an aspirational—but not mandatory—provision that extends the ADR consultation requirement to transactional attorneys.²⁷⁴ As Marshall Breger has argued in the litigation context, “a mandatory ADR consultation rule is only in part an attempt to dispense with the role of attorney discretion. It is also an attempt to establish norms and values that will subtly but surely provide the context for the use of that

²⁷¹ See *id.* at 433–36 (reviewing such arguments).

²⁷² See *id.* (discussing examples).

²⁷³ The State of Hawaii, for example, has modified its version of Model Rule 2.1 to provide that “[i]n a matter involving . . . litigation, a lawyer should advise a client of alternative forms of dispute resolution.” HAW. R. S.Ct. R.P.C. 2.1 (2003). Some states have taken a more broad approach. Massachusetts, for example, requires that “there will be circumstances in which a lawyer should advise a client concerning the advantages and disadvantages of available dispute resolution options in order to permit the client to make informed decisions concerning the representation.” MASS. ANN. LAWS S. JUD. CT. R. 3:07, R.P.C. 1.4 (2003). Assuming that “available dispute resolution options” should be read to include the use of transactional mediators, this provision is broad enough to apply to the contracting context. Scholars’ recommendations in this area are often litigation-focused as well. See, e.g., Breger, *supra* note 270, at 461 (proposing a revised comment to Model Rules of Professional Conduct Rule 1.4 that “[a] lawyer should take into consideration . . . alternatives to litigation.”) (emphasis added); Robert F. Cochran, Jr., *ADR, the ABA, and Client Control: A Proposal that the Model Rules Require Lawyers to Present ADR Options to Clients*, 41 S. TEX. L. REV. 183, 184 (1999) (proposing amendment to Model Rule 1.2 sufficiently broad to extend to transactional contexts but only analyzing the proposal in the litigation domain).

²⁷⁴ It may be that a mandatory provision is justified in the litigation context, in which an attorney may already have some duty to the court system to avoid unnecessary litigation, but not in the transactional context, in which there is no analogous duty. See *Jackson v. Philadelphia Hous. Auth.*, 858 F. Supp. 464, 472 (E.D. Pa. 1994) (suggesting that lawyers owe courts such a duty and thus should suggest mediation when appropriate).

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discretion.”²⁷⁵ The process of debating and adopting such a provision in state bar associations would educate a great many transactional attorneys about the potential for mediator assistance.

At the same time, the use of transactional mediators is in its infancy. As discussed above, currently a transactional mediation may not be privileged under state law or even permitted under the securities regulations. To require lawyers to promote such practices at this stage, therefore, seems premature. Instead, transactional lawyers should be encouraged to discuss retaining a mediator with their clients, but should not be disciplined for failing to do so.

VI. CONCLUSION

This Article has made the case for transactional mediators. I have argued that there are several theoretical justifications for third-party assistance in transactions. By looking closely at transactional bargaining through the various stages of a deal’s life, one can see opportunities for a mediator to add value. I have also presented preliminary evidence that such interventions are already taking place. This suggests that the time has come to reconsider how we define the scope and applicability of mediation. Rather than take a formalist approach to mediation, defining it as a dispute resolution device and thus limiting it to the disputing context, we should be more functional in our analysis. By doing so one can see the possibilities for using mediation to assist dealmakers with their transactional bargaining.

²⁷⁵ Breger, *supra* note 270, at 432.

