

JUNE 2011 NEWSLETTER

POZZUOLO RODDEN, P.C.
COUNSELORS AT LAW
2033 WALNUT STREET, PHILADELPHIA, PA 19103
215-977-8200/FAX 215-977-9663
www.pozzuolo.com



THE ADVANTAGES OF ALTERNATIVE DISPUTE RESOLUTION (ADR) TO A CLOSELY HELD BUSINESS

Before addressing this topic, Pozzuolo Rodden takes great pleasure in announcing the hiring of Stephen P. Taylor as an associate at the Firm where his primary focus is Corporate and Estate Taxation and Planning. He has a LL.M. in Taxation and JD graduate from Villanova University School of Law where he served as Managing Editor of the Villanova Sports and Entertainment Law Journal. Prior to joining Pozzuolo Rodden, PC, Stephen acquired extensive legal training by clerking with the IRS-Office of Chief Counsel, the Honorable Mary F. Walrath in the U.S. Bankruptcy Court for the District of Delaware and the Honorable Jack A. Panella of the Superior Court of the Commonwealth of Pennsylvania. Stephen received his undergraduate degree from the University of Michigan.

INTRODUCTION

In recent years, alternative dispute resolution (“ADR”) has become the buzz words for business disputes. ADR generally means providing a solution to a dispute other than through the traditionally

federal, state or county instituted court systems. There are generally two types of ADR: 1) mediation; and, 2) arbitration. Normally mediation is a nonbinding, informal proceeding to facilitate the parties to resolve their dispute independent of a binding judicial determination. Arbitration, on the other hand, is a contractual arrangement where parties decide to be bound by the decision of a third party (ies) in a non-governmentally instituted court proceeding. Mediation may facilitate a resolution, but does not require one, whereas arbitration is generally a more cost effective binding judicial solution outside of the traditional court system.

Mediation:

Mediation requires the two parties to the dispute to choose a third party, the mediator, who will facilitate non-binding negotiations to resolve the dispute. Mediation provides a highly cost effective forum to resolve a dispute when parties are not too far apart especially when the parties desire to have a future relationship. Mediation avoids the bridge burning of a more formal legal action.

The resolution of a dispute is sometimes frustrated by a lack of communication. The mediator can talk to each party individually asking them what they have to offer, what they desire, and what would be an acceptable resolution. Then the mediator can meet with all parties in a common room and commence communication. Further the mediator may even suggest creative solutions creating a win-win resolution such as negotiating better terms or the promise for future business.

Fostering communication may help reignite the business relationship between the two parties. Many times a relationship breaks down from a lack of communication. Similar to stories of how separated couples will start divorce proceedings within hours of an argument, the negotiations may allow each party to voice their frustrations and act as a safety valve to reduce the pressure of the business relationship.

Last, if a final resolution cannot be achieved, at least the parties will better understand the issues and the other party's point of view. After communicating, the parties will better learn each side of the dispute and may act more reasonably realizing the counterparty has a rational and reasonable point of view even if adverse to your own. Further, mediation may also bring the crucial issue to the surface to achieve a creative solution. For instance, two heated parties may realize the myriad of anger and hostility boils down to a breakdown in communication and the simple interpretation of a specific term such as what is meant by supplying a "high quality" or "satisfactory" goods in that industry.

The downside to mediation is that although, it may facilitate a resolution, it does not necessitate one, thus, the parties are not necessarily required to be cooperative. Mediation, in some instances, may spur more anger and hostility if the counterparty does not negotiate in good faith to bring about a solution. As a result, many contracts may allow the parties to waive such mediation for a more definitive binding dispute procedure such as arbitration or a traditional court proceeding if mediation would be futile.

Arbitration:

Benefits:

Arbitration is a highly attractive alternative to traditional court proceedings especially as: (1) disputes become highly specialized and industry specific; (2) there is a necessity for a timely resolution; and, (3) the parties are from multiple jurisdictions. Parties to a contract may agree to arbitration prior to or after the dispute arises. Parties may explicitly agree to binding arbitration to achieve certainty of:

- 1) the expertise of a decisions maker, the arbitrator, who has a deep understanding of the subject matter;
- 2) the avoidance of a runaway jury verdict;
- 3) a cost efficient and timely resolution;
- 4) a prior chosen law and forum; and,
- 5) procedures of the hearing.

A major advantage of arbitration is the ability to choose an arbitrator who has a thoroughly deep knowledge of the area of litigation. For example, for a dispute between a hydraulic press supplier and purchaser about whether purchaser's specifications were met, a traditional judge needs to learn terms of art such as the "stroke", "stroke control", "shut height", "daylight", and the "bolster." A judge would need to be educated on these terms requiring numerous experts. Furthermore, the judge will never have the practical knowledge that an expert arbitrator has. Even with months of study, the judge is far shy of the possible 30 plus years of the day to day experience in the hydraulic press industry of the expert arbitrator. Choosing an expert arbitrator ensures the decision maker fully understands the subject matter and improves the accuracy of the decision.

Another advantage of a chosen arbitrator is that in jury trials in a traditional court there is always the risk of a runaway jury. An injury of a plaintiff employee, whose story appeals to an urban jury, may be rewarded with five times what the reward deserved. A pre-chosen arbitrator or one chosen by both parties avoids the risk of the decision maker being swayed by sympathy for either party.

In addition, arbitration is generally more cost and time efficient. With field specific arbitrators, this may reduce the need to pay for additional expert testimony to educate the decision maker. With the judicial system backlog and red tape of formal court proceedings, decisions can be made sooner, and will reduce the administrative burden to litigate a dispute. This is especially important for closely held businesses that require a speedy resolution and do not have hundreds of thousands of dollars to spend on litigation.

Additionally, arbitration provides certainty as to choice of law and forum (location) of the arbitration. Different courts may be divergent in their law. For example, State A may, absent an explicit agreement, place the risk of lost or damaged goods on the purchaser while State B may place the burden on the seller. Two parties can agree that State A law should apply, thus providing more certainty that the purchaser will be liable in absence of a contrary term. Also, the parties could agree to the location of the proceeding for administrative convenience. This and the choice of law are especially important with multi-state and international transactions where the laws may be even more divergent or the local court may be biased towards its citizens, workers and businesses.

Finally, the parties may alter the court procedures to make it less formal or less invasive. Many traditional courts require formal rules of evidence, service (notice to the counterparty), or liberal discovery (allowing expensive, time consuming, burdensome discovery of documents from the counterparty). For example, if the local court of the counterparty requires service only through an authorized legal official such as a sheriff, then this rule is highly formal and costly. In arbitration, the parties can agree that service by certified mail is adequate. This avoids the administrative burden of overly restrictive procedural rules.

Enforcement of an Arbitration Award:

One downfall to arbitration is that the arbitrators do not have the same power as traditional courts to seize assets to enforce a judgment. However, if a losing counterparty refuses to honor the

arbitration award, the winning party may have it enforced in a traditional court. Under the international treaty of the New York Convention and the Federal Arbitration Act, arbitration awards are honored and respected in the United States and internationally. Awards are only rarely turned aside. Usually this is for a due process violation (failure to provide notice or a one-sided proceeding) or a public policy violation where it “violates the basic notions of morality and justice.” Further, arbitration awards are generally not overturned on the substance of the decision unless there is “manifest disregard of the law” where it would be obvious and readably perceivable for the arbitrator to award differently.

Conclusion:

Generally, arbitration provides the advantage of a better informed decision maker, the avoidance of a runaway jury, a more efficient and timely proceeding, and an ability to control the law, location and procedure of the tribunal. Further, arbitration awards are usually enforced and rarely overturned by traditional courts. They provide a speedy and cost effective alternative to the traditional court system especially with where business relations require the speed of time.

In summary, ADR methods provide a highly efficient, accurate, and timely alternative resolution to business disputes.

New Articles/Publications

1) Pozzuolo Rodden is pleased to announce that Jeffrey S. Pozzuolo, Esquire was the youngest of thirteen (13) experts chosen to be interviewed in the Spring 2011 Philadelphia Estate Planning Council article titled “What Experts have to Say About the Impact of New Tax Rules for Wealth Transfer”. A copy of this article is available by emailing your request to chrissy@pozzuolo.com, and;

2) Joseph R. Pozzuolo, Esquire, Jeffrey S. Pozzuolo, Esquire, and Florence L. Simonis, Esquire are pleased to announce the publication of their article titled Estate Planning For Pet Owners, in the March 2011 issue of Practical Tax Strategies a publication produced by Thomson Reuters/WG&L. This article may be viewed at our web site: www.pozzuolo.com.

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Publications

All of the following professional publications and past newsletters written by attorneys of this office are available by clicking here: [http://pozzuolo.com/Pubs Articles.shtml](http://pozzuolo.com/Pubs%20Articles.shtml)

Corporate/Tax

Design Buy-Sell Agreements For Maximum Utility

Deferred Compensation Rewards And Retains Key Employees

How To Use Non-Qualified Deferred Compensation Arrangements As A Business, Retirement And Tax Planning Tool

Protecting A Client's Business From Unfair Competition Using Restrictive Covenants

Money Purchase Pension Plan Falls Out Of Favor

Why An Employment Contract Is Mandatory

What Type of Qualified Corporate Retirement Plan Best Serves Your Business, Tax And Retirement Needs

Structuring Loans From Qualified Plans - How To Handle The Strict Tax Rules

How An S Corporation Avoids The Double Taxation Incurred When Excessive Compensation Is Treated As A Dividend

Bankruptcy - How To Prevent It And How To Cope With It Should It Happen To Your Business

How To Look, Act And Sound Like A Professional Corporation

How Mortgage Lenders Should Draft Broker Agreements To Avoid RESPA Violations

How to Structure a Suitable Buy-Sell Agreement

Estate Planning

Estate Planning For Pet Owners

The Limited Liability Company -A Sophisticated Tool For Estate Planning

Diversify Strategies For An Effective Estate Plan

Use Wills To Maximize Family Protection And Minimize Tax

Six Proven Estate Planning Techniques

Divorce Raises The Need For Performing An Estate Planning Review

Divorce and Estate Planning

Remarriage Situations Can Raise Special Estate Planning Considerations

College Funding Tool Offers Estate Planning Advantage

Drafting The Durable Power Of Attorney For Wealth Protection Purposes

Why Living Wills Advance Directives Are An Essential Part Of Estate Planning

Special Needs Trust - An Estate Planning Tool For The Disabled

Adapt Estate Planning Strategies to Fit the Needs of Same-Sex Couples

Actual resolution of legal issues depends upon many factors, including variations of facts and state laws. This newsletter is not intended to provide legal advice on specific subjects. It is to provide insight into legal developments and issues. You should always consult with legal counsel before taking any action on matters covered in our updates.

This newsletter is courtesy of Pozzuolo Rodden, P.C.

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