NOTE NUMBER 329

viewpoint

PUBLIC POLICY FOR THE **PRIVATE SECTOR**

THE WORLD BANK GROUP FINANCIAL AND PRIVATE SECTOR DEVELOPMENT VICE PRESIDENCY OCTOBER 2011

Settling Out of Court

How Effective Is Alternative Dispute Resolution?

Inessa Love

Inessa Love (ilove@worldbank.org) is a senior economist in the World Bank's Development Research Group.

This Note was written as part of the Investment Climate Impact Project, a joint effort of the World Bank Group's Investment Climate Department, IFC's Investment Climate Business Line, and the World Bank's Development Research Group, in collaboration with IFC's Development Impact Department, the Development Impact Evaluation Initiative, the FPD Chief Economist's Office, and the Global Indicators and Analysis Unit. The project is funded by the U.S. Agency for International Development and the World Bank Group's Investment Climate Department.

THE WORLD BANK

IFC International Finance Corporation
World Bank Group

Alternative dispute resolution can help the justice system in a country function more efficiently. It often saves costs and time and increases user satisfaction. For cases that go back to court, however, the total cost and time may increase. Alternative dispute resolution can also have indirect benefits. It can increase the effectiveness of courts by reducing bottlenecks. And it can improve trust in the legal system, which may increase foreign investment.

The ability to enforce contracts is essential to support efficient allocation of resources and growth in an economy. The ease with which contracts can be enforced varies dramatically across economies. According to data from the World Bank's Doing Business project, the time required to enforce a contract (from the moment the plaintiff files the lawsuit until payment is made) ranges from about five months in Singapore and seven in New Zealand to more than four years in Guatemala, Afghanistan, and Suriname. The cost ranges from less than 10 percent of the contract value in Iceland, Luxembourg, and Norway to more than 100 percent in such countries as Cambodia, Indonesia, and Sierra Leone.

Among the reasons that contract enforcement is so inefficient in many countries are lack of modern laws, deficient and underfunded court systems, and prevalent corruption. Alternative dispute resolution (ADR) has emerged as an alternative to court litigation that may offer a more efficient and less expensive avenue for resolving disputes. It provides confidentiality, choice of neutral parties, more flexibility of procedure, and other benefits. This Note summarizes the findings of the literature on the effectiveness of ADR mechanisms as an alternative to traditional litigation.

What is ADR?

ADR is defined as any process or procedure other than adjudication by a presiding judge in court—litigation in which a neutral third party assists in or decides on the resolution of the issues in dispute (Rozdieczer and Alvarez de la Campa 2006). Among the many different types of ADR processes, the most common are mediation, arbitration, and conciliation (box 1). Others include early neutral evaluation, summary jury trial, mini-trial, and settlement conference.

But even the same process can be applied in many different ways.[1] There are also differences in the extent of ADR in a country. ADR may involve a small center in a single location—or a network of large centers around the country.

Box 1 Common types of alternative dispute resolution

- *Arbitration* involves using a neutral arbitrator to make a decision about the outcome of the dispute. Once the parties have agreed to the process, arbitration is binding (the decision is final and can be appealed only on very narrow grounds).
- *Mediation* is a process in which a neutral mediator helps the parties discuss and find a mutually acceptable solution.
- *Conciliation* is a variation of mediation in which a conciliator meets with the parties separately (rather than jointly, as in mediation) and seeks concessions from the parties that would help resolve the dispute. Unlike arbitration, conciliation is not legally binding.
- *Early neutral evaluation* is a process in which a case is referred to an expert, usually an attorney, who provides a balanced and unbiased evaluation of the dispute and offers an opinion on the likely outcome of a trial.

Source: Rozdieczer and Alvarez de la Campa 2006.

It can involve different types of disputes—such as between businesses, between employees and management, between businesses and creditors (insolvency, restructuring), between investors and the state (investment treaty arbitration), or between businesses and the government (tax disputes).

All these differences make ADR a rich field, but they also make evaluating its effectiveness more difficult. Different processes and applications may have different impacts, making it difficult to make any general statements about the overall effectiveness of ADR. In addition, the legal treatment of ADR processes differs in different jurisdictions, and the impact of an ADR process will depend on local laws. Finally, one case can differ significantly from another, and subjecting the same case to different processes is not feasible (see Menkel-Meadow forthcoming; and Stipanowich 2004).

Impact on cost

Many studies have explored the effectiveness of ADR in reducing the costs of dispute resolution relative to litigation.[2] Estimates of cost savings vary substantially from study to study, depending on the type of ADR process evaluated, the type of cases, the type of intervention, and the local conditions. As table 1 shows, estimates of the total costs incurred by firms that use an ADR process range from 3 to 50 percent of the costs incurred by firms that go through a court litigation process.

One study, performed by staff of the International Finance Corporation (IFC 2006), looked at the introduction of ADR centers in Serbia, Bosnia and Herzegovina, and the former Yugoslav Republic of Macedonia. It evaluated more than 1,000 cases resolved through mediation and compared the outcomes with those of similar court cases.[3] The study finds that in Bosnia and Herzegovina the direct costs of mediation averaged US$225, about 50 percent of the costs of litigation (about US$470).

Jorquiera and Alvarez (2005), surveying firms in nine Latin American countries on their use of ADR, found that the firms relied on ADR in 26 percent of

Table 1 Cost savings with alternative dispute resolution relative to court litigation

Country or countries	Study	Reform	ADR cost as % of litigation cost
Bosnia and Herzegovina, FYR Macedonia, Serbia	IFC 2006	Introduction of ADR centers	50
Colombia	Alvarez de la Campa 2009	Conciliation made mandatory (before court filings)	40–50
9 Latin American countries	Jorquiera and Alvarez 2005	ADR use	3–18
Country	**Study**	**Reform**	**Cost savings (US$)**
United States	Barkai and Kassebaum 1992	Court-annexed arbitration program	500 (per party)
United States	Cited in Stipanowich (2004)	Introduction of early mediation pilot programs in 4 superior courts	6,000 (per case)
Canada	Hann and Baar 2001	Introduction of mandatory mediation in Ottawa and Toronto	6,000 (per case)

cases and the judicial system in 17 percent (private negotiations were used the most). Using firms' survey responses, the authors analyze relative costs for a hypothetical company in Argentina. They report costs of US$431 for mediation, US$2,536 for arbitration, and US$14,295 for litigation. Uniquely, this analysis attempts to factor in all costs, including the cost of time invested, the opportunity costs of capital, and legal costs.

Other studies of ADR found that it saved about US$500 per party in the United States (Barkai and Kassebaum 1992) and about US$6,000 per case in Canada (Hann and Baar 2001). But savings in Canada varied widely, ranging from only about US$2,000 to more than US$20,000.

For cases that fail to reach resolution through ADR, the total costs can be higher. Many cases that attempt to use ADR, mainly under mandatory mediation, end up in court anyway.[4] Genn and others (2007) study an involuntary program, automatic referral to mediation, introduced in London. Of 1,232 cases referred to the program, only 14 percent were mediated; the rest went back to court.[5] The settlement rate was 55 percent in no-objection cases, and 48 percent in cases where parties were persuaded to mediate. The study estimates that for cases that failed to reach settlement through ADR, total legal costs were US$2,000–4,000 higher than they would have been if no attempt had been made to use ADR.

Rosenberg and Folberg (1994) use a randomized experimental design to study early neutral evaluation (ENE) in California. They report that while about 40 percent of parties believed that they saved money with ENE, 38 percent of attorneys and parties believed that ENE added about US$4,000 on average to the cost of litigation. Wissler (2004), reviewing 27 studies of general civil mediation, also reports mixed results on cost savings.

Impact on time

The time it takes to resolve a dispute through an ADR process relative to traditional litigation is also of interest in evaluating the effectiveness of ADR. This time is also referred to as time to disposition, measured as the total time from filing a complaint to settling the case. Researchers use a variety of methods to study differences in time, including surveys, archival data sources, and randomized experiments. The estimates of the differences in time between ADR and traditional litigation vary widely among studies, again depending on the ADR mechanism.[6] The time savings found range from one month to about a year (table 2).

Rosenberg and Folberg (1994), in their study of the ENE program in California, find that it shortened the time compared with a court process.[7] Similarly, Hann and Baar (2001), studying a mandatory mediation program in Canada, find that mediation resulted in more cases being settled sooner. At six months, for example, 25 percent of cases under the mandatory mediation rule were disposed, compared with only 15 percent of control cases.

Barkai and Kassebaum (1992) find that the court-annexed arbitration program in Hawaii was four months faster on average than traditional litigation. Wissler (2004) reports that in five studies of appellate cases, the time to disposition was one to three months shorter for cases assigned to mediation than for other cases. Bingham and others (2009), studying outcomes of ADR use by the U.S. federal government, estimate that ADR saved about 88 hours of staff time and about 6 months of litigation time per case—showing that ADR can reduce public costs as well as private.

While there are many studies of ADR effectiveness in the United States and a few other developed countries, there are very few such studies in developing countries. One of these is by Alvarez de la

Table 2 **Time savings with alternative dispute resolution relative to court litigation**

Country	Study	Reform	Time savings (months)
Colombia	Alvarez de la Campa 2009	Conciliation made mandatory (before court filings)	11
United Kingdom	Genn and others 2007	Introduction of quasi-compulsory automatic referral to mediation	None
United States	Bingham and others 2009	ADR use by federal government	6
United States	Cited in Stipanowich (2004)	Introduction of early mediation pilot programs in 4 superior courts	1
United States	Barkai and Kassebaum 1992	Court-annexed arbitration program	4

Campa (2009), who studied a reform in Colombia that made conciliation mandatory before court filings in 2001. He reports that tenant eviction cases took 15 months on average in court but only 4 months in mandatory conciliation.

Yet some studies find no significant reduction in the duration of cases with ADR. An early study of the introduction of ADR in the United States known as the RAND report, produced in 1996, concluded that there was "no strong statistical evidence that the mediation or neutral evaluation programs significantly affected time to disposition, litigation costs or attorney view of fairness and satisfaction" (Stipanowich 2004, p. 852). Later research questioned and criticized these conclusions.[8] More recently, however, Genn and others (2007) reported no significant impact of mediation on total case duration. This was the finding of a formal survival analysis of case duration using data from a randomized experiment of mediation assignments and controlling for case value, case type, and presence of counterclaim. Wissler (2004), reviewing 27 studies of general civil mediation, also reports mixed results on differences in case duration.

Impact on other outcomes

The direct impacts of cost and time savings for those participating in ADR are the easiest to measure. But ADR processes can have other direct impacts for ADR participants as well as indirect impacts benefiting even those who do not participate directly in ADR.

Among the direct impacts noted for ADR participants, one is clients' higher satisfaction with ADR outcomes (Rosenberg and Folberg 1994). Others might include jobs retained rather than lost or new jobs created. The IFC report (2006) notes that because ADR resolutions are faster, they may allow plaintiffs to avoid bankruptcy thanks to receiving the payment earlier, and may allow defendants to avoid a negative public image. These direct impacts are more difficult to measure (because of the lack of counterfactuals), and no empirical evidence on these impacts has been found.

Indirect impacts of ADR may include increasing the effectiveness of courts, which benefits firms that are going through the courts rather than an ADR process. ADR can improve the functioning of the formal court system by reducing the number of court cases filed (by diverting some cases that would have ended up in court to the ADR process) and thus alleviating bottlenecks in courts. Barkai and Kassebaum (1992) find that after the court-annexed arbitration program was introduced in Hawaii, the backlog in courts decreased. Gropper (2010) reports that after the introduction of an ADR process for tax appeals in Pakistan, the number of pending cases fell from 2,500 to 770. In the United States there has been a long debate on the "vanishing trials" (the pronounced decline in rates of trial in past decades), with some noting the important role ADR has played in this trend (Stipanowich 2004). Wissler (2004) reports that a mediation program can save costs for the courts by reducing the caseloads of judges and their staff.

ADR may have another intangible benefit: improving the perceived quality of the legal system and increasing trust in the fair resolution of conflicts. Chemin (2010) finds a causal relationship between improvements in court speed in India and outcomes for firms, such as increased investment and better access to finance. The IFC study of Balkan countries (2006) reports survey evidence of greater trust in the legal system among clients who used mediation.

ADR may also affect investors' perceptions. Judicial system weaknesses are often cited as a constraint on foreign investment in emerging markets (EIU 2007). ADR can improve foreign investors' perceptions of the business environment in a country, which may result in more foreign investment (see, for example, World Bank Group 2010). In addition, foreign investors prefer ADR mechanisms to transnational litigation (PWC 2006), and as of September 2011, 146 parties had ratified the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (also known as the New York Convention).[9] But there is no direct evidence of increased foreign investment as a consequence of introducing ADR.

Other less tangible benefits of ADR include improvements in the quality of business relationships and in problem-solving skills. The IFC study (2006) claims that introducing ADR improved professional and business relationships and supported the continuation of business relationships because of the nonadversarial nature of mediation. Similarly, a PricewaterhouseCoopers survey (PWC 2006) finds that the continuation of business relationships is an important factor in firms choosing to use ADR. The survey by Wissler (2004), however, reports mixed results on litigants' relationships.

Another possible effect of mediation could be an improvement in conflict resolution skills allowing parties to take responsibility for solving their own problems in the future.

There is no empirical evidence on the effect of ADR on other important economic outcomes, such as investment, employment, access to credit, insolvency, and growth.

Conclusion

The evidence on the cost and time savings of ADR programs for parties in a dispute is growing. Yet while some ADR processes (such as binding arbitration) offer final solutions, with others there is a risk that cases will go back to court, and this may increase the total cost and time. Thus for policy makers seeking to improve the efficiency of court systems, maximizing the share of ADR cases that are successfully resolved should be a priority.

Moreover, cost and time savings might be just the tip of the iceberg. The indirect impacts—such as improvements in court effectiveness, the business environment, and trust in the legal system—could potentially be even more important in the overall contribution of ADR to economic development. There is almost no research on these indirect impacts, which are less tangible and more difficult to measure.

ADR programs appear to be an attractive option in many developing countries because of their slow and ineffective courts. ADR could alleviate courts' case backlogs and improve their effectiveness. But this should not be a prescription for reducing the importance of well-functioning courts, which remain the backbone of the justice system. In support of that, Voigt (2009) finds that ADR programs complement state dispute resolution: better quality of courts is associated with more frequent use of ADR services. This suggests that ADR should be developed alongside improvements in the traditional litigation processes.

One conclusion of this review is that there is a lack of quality empirical studies of the effectiveness of ADR, especially outside the United States. For example, Bingham and others (2009) note that "most scholars and commentators agree that there is insufficient empirical research about the efficacy and success of ADR as compared to traditional litigation" (p. 3). More research is clearly needed on this topic, and multilateral institutions such as IFC and the World Bank could play an important part in filling some of the key gaps.

Notes

The author is grateful for helpful comments from Donna Stienstra, Marialisa Motta, Lada Busevac, Massimiliano Santini, Nina Pavlova Mocheva, Gabriela A. Armenta, and Akvile Gropper.

1. For example, mediation can be facilitative (a mediator simply assists the parties and offers no opinion) or recommendation based (a mediator plays a more active role and offers suggestions on the case). In addition, different processes can be court operated, court referred, or operating outside the court. And they can be voluntary or involuntary, consensual or directive, binding or nonbinding, formal or informal, and so on.
2. This survey is representative of existing studies while not attempting to include them all. For other surveys of mostly U.S. literature, see Bingham and others (2009), Menkel-Meadow (forthcoming), and Ward (2007).
3. Many studies are based on nonrandom assignment of cases to ADR, which leaves a concern that firms that chose to use ADR could differ in some unobservable ways from firms that did not and thus that the outcomes may be attributable at least in part to these differences rather than to the effectiveness of ADR.
4. Returning to court is more common with involuntary mediation. Parties voluntarily choosing mediation rarely go back to court. The arbitration agreements are usually binding, and parties give up their right to go to court. But arbitration awards can be set aside or annulled by local courts, which, though it does not happen often, can prolong dispute resolution and increase costs.
5. Mandatory programs, often subsidized, are aimed at reducing backlogs as much as possible or preventing the creation of new ones, and usually involve judges as mediators. Voluntary programs within courts have greater flexibility and therefore result in greater acceptance rates.
6. Arbitration may take longer than other types of ADR such as mediation, because arbitration is an adjudication-based process and for the most part resembles a litigation process that occurs in a private venue with the third-party neutral decision maker.
7. Rosenberg and Folberg report their findings as the percentage of cases closed by a certain date. They find that

for any date considered between 60 days and 240 days, a higher share of ENE cases have been resolved. After 240 days about 48 percent of ENE cases have been resolved, compared with only 40 percent of non-ENE cases.

8. Among the critiques of the RAND report are that the sampled programs were not representative of other programs in operation and that some of the programs had significant design flaws that were later corrected (Stipanowich 2004).

9. United Nations Convention on International Trade Law (UNCITRAL), "Status: 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards," http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html (accessed September 22, 2011).

References

Alvarez de la Campa, Alejandro. 2009. "The Private Sector Approach to Commercial ADR: Commercial ADR Mechanisms in Colombia." Investment Climate Department, World Bank, Washington, DC. http://www.fias.net/index.cfm.

Barkai, John, and Gene Kassebaum. 1992. "Hawaii's Court-Annexed Arbitration Program: Final Evaluation Report." PCR Working Paper Series 1992-1, Program on Conflict Resolution, University of Hawaii at Manoa.

Bingham, Lisa Blomgren, Tina Nabatchi, Jeffrey Senger, and Michael Scott Jackman. 2009. "Dispute Resolution and the Vanishing Trial: Comparing Federal Government Litigation and ADR Outcomes." *Ohio State Journal of Dispute Resolution* 24 (2): 1–39.

Chemin, Matthieu. 2010. "Does Court Speed Shape Economic Activity? Evidence from a Court Reform in India." *Journal of Law, Economics, and Organization*, advance access, November 11, 2010.

EIU (Economist Intelligence Unit). 2007. "World Investment Prospects to 2011: Foreign Direct Investment and the Challenge of Political Risk." London.

Genn, Hazel, Paul Fenn, Marc Mason, Andrew Lane, Nadia Bechai, Lauren Gray, and Dev Vencappa. 2007. "Twisting Arms: Court Referred and Court Linked Mediation under Judicial Pressure." Ministry of Justice Research Series 1/07, Research Unit, U.K. Ministry of Justice, London.

Gropper, Akvile. 2010. "ADR in Tax Disputes." Research Note, World Bank, Washington, DC.

Hann, Robert, and Carl Baar. 2001. "Evaluation of the Ontario Mandatory Mediation Program (Rule 24.1): Executive Summary and Recommendations." http://www.attorneygeneral.jus.gov.on.ca/.

IFC (International Finance Corporation). 2006. "Evaluation of the PEP SE ADR Projects in Bosnia and Herzegovina, Serbia and Macedonia." Washington, DC.

Jorquiera, Carlos Eugenio, and Gabriel Dabdoub Alvarez. 2005. "The Cost of Disputes in Companies and the Use of ADR Methods: Lessons from Nine Latin American Countries." MIF Study, Multilateral Investment Fund, Washington, DC.

Menkel-Meadow, Carrie. Forthcoming. "Empirical Studies of ADR: The Baseline Problem of What ADR Is and What It Is Compared To." In *Oxford Handbook of Empirical Legal Studies*, ed. Peter Cane and Herbert Kritzer. Oxford: Oxford University Press. Also available at ssrn.com/abstract=1485563.

PWC (PricewaterhouseCoopers). 2006. *International Arbitration: Corporate Attitudes and Practices 2006.* http://www.pwc.co.uk/eng/publications/International_arbitration.html.

Rosenberg, Joshua, and H. Jay Folberg. 1994. "Alternative Dispute Resolution: An Empirical Analysis." *Stanford Law Review* 46: 1487–551.

Rozdieczer, Lukasz, and Alejandro Alvarez de la Campa. 2006. *Alternative Dispute Resolution Manual: Implementing Commercial Mediation*. Washington, DC: World Bank Group.

Stipanowich, Thomas. 2004. "ADR and the 'Vanishing Trial': The Growth and Impact of 'Alternative Dispute Resolution.'" *Journal of Empirical Legal Studies* 1 (3): 843–912.

Voigt, Stefan. 2009. "Does Arbitration Blossom When State Courts Are Bad?" Available at ssrn.com/abstract=1325479.

Ward, Ettie. 2007. "Mandatory Court-Annexed Alternative Dispute Resolution in the United States Federal Courts: Panacea or Pandemic?" St. John's University Legal Studies Research Paper Series 07-0077, St. John's University School of Law, Jamaica, NY.

Wissler, Roselle. 2004. "The Effectiveness of Court-Connected Dispute Resolution in Civil Cases." *Conflict Resolution Quarterly* 22: 55–88.

World Bank Group. 2010. *Investing Across Borders 2010.* Washington, DC: World Bank Group. http://www.investingacrossborders.org.

viewpoint

is an open forum to encourage dissemination of public policy innovations for private sector–led and market-based solutions for development. The views published are those of the authors and should not be attributed to the World Bank or any other affiliated organizations. Nor do any of the conclusions represent official policy of the World Bank or of its Executive Directors or the countries they represent.

To order additional copies contact Ryan Hahn, managing editor, Room F 4P-252A, The World Bank, 1818 H Street, NW, Washington, DC 20433.

Telephone: 001 202 473 4103
Fax: 001 202 522 3480
Email: rhahn@worldbank.org

Produced by Carol Siegel

Printed on recycled paper