

How Mediation Can Help Corporations Survive the Recession

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INTRODUCTION

Hong Kong is in the midst of a financial turmoil. The number of companies that went into liquidation has surged. Production lines in the Mainland and retail outlets were shut down, notwithstanding they were operated by listed companies in Hong Kong. The stock index plunged to a 5-year low and financial institutions are tightening their credit policies, causing additional cash flow problems to enterprises.¹

Economic downturn will also surface conflicts and create disputes. There will be failed or anticipatory breach of contracts, employment / labour disputes due to downsizing, workplace conflict that follows major company restructuring, boardroom disputes as to company's strategies and shareholders disputes in connection with alleged management misconducts or undervalue of companies' shares in takeovers or unfair prejudice petitions.²

This article aims at explaining how mediation works through institutionalized mediation schemes in Hong Kong, and why it would be helpful to customize these schemes into in-house mediation scheme for various corporations in resolving disputes at the time of economic recession.

MEDIATION AND LITIGATION

The term "Mediation" is used interchangeably by the World Trade Organization with "Conciliation", and is defined in the UNCITRAL Model Law on International Commercial Conciliation (2002) Article 1 as a process "*whereby parties request a third person or persons to assist them in their attempt to reach an amicable settlement of their dispute arising out of or relating to a contractual or legal relationship.*"³ Mediator will not evaluate the substance of the dispute and has no authority to impose a solution upon the parties to the dispute. It is a

¹ Chan, John, "Hong Kong Enters Recession", *World Socialist Web Site*, International Committee of the Fourth International, 21 November 2008, (accessed at <http://www.wsws.org/articles/2008/nov2008/hong-n21.shtml>)

² Loh, Timothy, "PCCW Privatization: A Guide to the Applicable Law for Schemes of Arrangement", *Financial Services and Law Review*, Vol. 2 (2009) (accessed at <http://www.legal500.com/c/hong-kong/developments/6589>); See also Tang and Wong, "Citic Pacific Under Investigation After Currency Loss", *Bloomberg Press*, 22 October, 2008 (accessed at: <http://www.bloomberg.com/apps/news?pid=20601087&sid=ay4CUWXsD7Po&refer=home>)

³ UNCITRAL Model Law on International Commercial Conciliation (accessed at: <http://www.uncitral.org/pdf/english/texts/arbitration/ml-conc/ml-conc-e.pdf>)

consensual and confidential process conducted on a “without prejudice” basis.⁴

In practice, the mediator deploys an interest-based approach to help parties resolve issues of mutual concerns. It is typically initiated by an agreement to mediate, followed by an exchange of written submissions. Unlike submissions in litigation, mediation submission is usually brief and will focus on future, discussing parties’ commercial interests. When the mediator deems appropriate, a joint meeting will be arranged. After an opening session, the mediator will meet privately in turn with each party, conducting “shuttle diplomacy”.⁵

Skillful mediators can reframe underlying conflicts into scenarios where parties can cooperate for joint gains.⁶ Through open and frank discussion during private meetings, the mediator will learn information which parties are reluctant to reveal to the other party and use that information to forge a settlement agreement. Without divulging the confidential information, the mediator will use the information to assist parties to review issues from various angles and facilitate valuable trade-offs. Parties could then assess the dispute realistically and see the outline of an optimal agreement that they would have failed to see in ordinary negotiation due to the concealment of information. Parties can then generate options to “increase the size of the pie” before distributing the values according to their needs.⁷

This feature of mediation differentiates itself with other adjudicative processes, including arbitration where the adjudicator imposes a binding decision upon the parties. The decision is distributive in nature --- the winner takes all and a zero-sum outcome is resulted. Moreover, litigation can only deal with the legal aspect of a dispute and disregards the relationship and other non-legal norms which may be relevant to the resolution of dispute. Court remedies are usually monetary compensation, with specific performance and equitable remedies available in some occasions. On the contrary, Mediation deals not only with the legal aspect, but also the commercial and emotional dimensions that present in every dispute. A wide range of solutions from a simple apology to any creative commercial arrangement can be agreed upon. They are only limited by practical considerations of a given circumstance or the creativity of the parties.⁸

MEDIATION SCHEMES

The benefits of using mediation as an alternative to litigation are proven in many

⁴ UNICITRAL Model Law on International Commercial Conciliation (accessed at: <http://www.uncitral.org/pdf/english/texts/arbitration/ml-conc/ml-conc-e.pdf>)

⁵ Runessun and Guy, *Mediating Corporate Governance Conflicts and Dispute*, International Finance Corporation of World Bank Group, 2007 at p.26

⁶ *Dunnet v Railtrack plc* [2002] EWCA Civ 302 at [14]

⁷ Runessun and Guy, at p.26, see note 5

⁸ See also Runessun and Guy at pp.28-29, *supra* note 5,

jurisdictions. Insofar as corporate governance is concerned, there is obviously a niche for mediation service to be promoted in the commercial sector. It can serve as a tool for commercial entities to manage relationship with business counterparts and resolve disputes efficiently and expeditiously. That said, the awareness of mediation in Hong Kong is low. Most potential users are ignorant as to the process as well as how to engage in mediation services, including the steps of selecting of mediator, exchanging documents and preparing for negotiation. To fill the gap, mediation schemes are developed in Hong Kong to offer a neutral platform on which guidance is provided to disputants in a user-friendly manner. This section would discuss the current mediation schemes in Hong Kong.

(1) Lehman Brothers-related Investment Products Dispute Mediation and Arbitration Scheme

One of the most contentious issues confronting Hong Kong lately is one which relates to the minibonds of Lehman Brothers. The saga has been dragged on since mid-September and the banks have failed to address the grievances of the investors in a timely manner.

On 15 September, 2008, Lehman Brothers, one of the most prestigious investment banks in the US, filed for bankruptcy protection. The bankruptcy was a corollary of the aggressive expansion of Lehman into property-related investments, including sub-prime mortgages - loans to the low income group or people with poor credit history. The economic downturn had brought Lehman a loss of \$39 billion in the third quarter of 2008 after being forced to take huge write-downs on the value of those investments.⁹

More than 48000 investors in Hong Kong have invested in structured products issued or guaranteed by Lehman Brothers. The total amount of investment involved in these products, namely the 'minibonds' or 'promissory notes', amounts to HK\$20 billion¹⁰. As a result of the bankruptcy, these investments have lost the majority of their value and in some cases become worthless. The residue value of the investment, if any, is under protection of the bankruptcy order.

Hundreds of angry investors marched to the headquarters of the Government, offices of regulatory bodies and the banks, demanding their investment back. In response to the public outcry, the Hong Kong government proposed a plan to buy back the investments at their current estimated value, which will allow investors to partially recover some of their loss.¹¹ Investors who aimed at recovering their full investment principal, filed complaints with the Hong Kong Monetary Authority (HKMA), the banking regulator of Hong Kong, alleging the

⁹ Press Release, "Lehman Brothers Holdings Inc. Announces that it Intends to File Chapter 11 Bankruptcy Petition", Lehman Brothers, 15 September 2008 (accessed at: http://www.lehman.com/press/pdf_2008/091508_lbhi_chapter11_announce.pdf)

¹⁰ Chen Bonnie, "Minibond investors urged to try mediation", *The Standard*, March 26, 2009; See also Policy Committee, *Proposal for Resolution of Mini-bond Issue*, Hong Kong Democratic Foundation, November 2008

¹¹ "Banks to buy back Lehman mini-bonds", *The Standard*, 17 October 2008

banks of fraud and/or misconduct during the sale of investment products. By the end of October, the Legislative Council has also established a special committee making enquiry into the mini-bond affair.¹²

The Deadlock

The Securities and Futures Commission

Of the 20,578 complaints filed with HKMA by the end of March 2009, only 414 have been referred to the Securities and Futures Commission (SFC), the regulator of investment brokers, for further investigation.¹³ Notwithstanding their power to investigate the complaints and take disciplinary actions against the intermediaries concerned pursuant to s196 of the Securities and Futures Ordinance (Cap 571)¹⁴, the investigation may take considerable time and even if intermediaries are found to be guilty of misconduct and reprimanded, this will not of itself provide compensation to investors.¹⁵ Although settlement may be offered by the banks, the number of cases that would be settled is patchy and represents only a tiny fraction of the total number of complaints.¹⁶

Litigation and Direct Settlement

Given the circumstance, the only remedies available to investors would be to negotiate a direct settlement with their banks, or to sue them for misrepresentation or negligence. Insofar as litigation is concerned, investors would have to engage lawyers in preparing their cases. The cost is likely to be disproportionate and the case may take years to conclude, with a possibility of an appeal. On the other hand, the banks are also proactively identifying and settling the egregious cases to reduce the likelihood of a successful suit.¹⁷ For investors who lack the resources to litigate and whose cases did not fall within the ambit of private settlement, the banks would normally deny liabilities and refused further negotiation.

The Consumer Council

Investors had also turned to the Consumer Council, seeking financial assistance for legal action under its Consumer Legal Action Fund (CLAF). The Council is

¹² "LegCo to Debate Assisting the Victims of the Lehman Brothers Incident" 20/10/2008 (accessed at: <http://www.info.gov.hk/gia/general/200810/20/P200810200198.htm> ; On 12 November 2008, it voted to invoke its powers under the Legislative Council (Powers and Privileges) Ordinance to conduct a public probe of Hong Kong banks that have been accused of misselling.

¹³ Press Release, "HKMA refers 28 Lehman-Brothers-related cases to the SFC for further action", Hong Kong Monetary Authority, 27 March 2009 (accessed at: http://www.info.gov.hk/hkma/eng/press/2009/20090327e4_index.htm)

¹⁴ accessed at <http://www.hkllii.org/hk/legis/ord/571/s196.html>

¹⁵ "Sun Hung Kai Investment Services Ltd agrees with SFC to repurchase Minibonds from its clients at original value " *Enforcement News*, Securities and Futures Commission, 22 January 2009

¹⁶ *Ibid.*

¹⁷ "雷曼迷債和解個案至今逾百宗，料涉資6 0 0 0萬元", *經濟通*, 13 January 2009

incorporated pursuant to the Consumer Council Ordinance (Cap 216).¹⁸ S4 (1) of the Ordinance provides for the functions of the Council:

“The functions of the Council are to protect and promote the interests of consumers of goods and services and purchasers, mortgagors and lessees of immovable property by- (a) collecting, receiving and disseminating information concerning goods, services and immovable property; (b) receiving and examining complaints by and giving advice to consumers of goods and services and purchasers, mortgagors and lessees of immovable property; (c) taking such action as it thinks justified by information in its possession, including tendering advice to the Government or to any public officer; (d) encouraging business and professional associations to establish codes of practice to regulate the activities of their members; (e) undertaking such other functions as the Council may adopt with the prior approval of the Chief Executive in Council”¹⁹

Simply speaking, the Council acts as the advocate for consumer interests; and provides conciliation services whenever disputes arise between consumers and vendors. Despite the Council’s intention to marshal representative cases for lawsuit against the banks in relation to the brokerage of Lehman Brothers related derivatives,²⁰ it is questionable as to whether the Consumer Council has such power pursuant to the Ordinance. First, the investors may not fall within the meaning of ‘consumer’ as stipulated in the Ordinance. Second, the Ordinance does not seem to confer power to the Council to prosecute banks or financial intermediaries for misconduct in the course of brokering investment products. If an action is brought against the banks under the CLAF, the legality of such action will be highly questionable as the CLAF is a trust fund established for protecting consumers’ interest.²¹

The Small Claims Tribunal

A group of 135 investors, whose claims do not exceed HK\$50,000, have sought to recover their money by filing suits against the bank in the Small Claims Tribunal (SCT). It took 3 months for the Adjudicator of SCT to hear all cases, but had subsequently come to a conclusion that the claims were to be referred to the District Court. The Adjudicator was of the view that the cases concerned banks' responsibilities and the risks to customers, of which new and complicated legal points of view involved. These points of law would have an impact on the public and banking sector. In addition,

¹⁸ accessed at <http://www.hklii.org/hk/legis/ord/216/s4.html>

¹⁹ accessed at <http://www.hklii.org/hk/legis/ord/216/s4.html>

²⁰ Press Release, “Consumer Council has put in place a special workforce to handle the Lehman Brothers cases”, The Consumer Council, 30 October, 2008 (accessed at: http://www.consumer.org.hk/website/ws_en/news/press_releases/2008103001.html)

²¹ Wong On Yin, “What does the Consumer Council Do?”, 27 October 2008 (accessed at: <http://wongonyin.mysinablog.com/index.php?op=ViewArticle&articleId=1408192>)

there was no precedent case in this regard and the tribunal may not have the legal power to handle such cases.²² Notwithstanding the above reasons, it can be reasonably anticipated that even if the cases are tried in the SCT, the probability of an appeal is high and the cases would eventually end up with the Court of Appeal. It followed that if the investor lost their case, s/he would have to pay not only his own costs but those of the bank - a daunting prospect for most individuals.

Class Action in USA

Despite thousands of aggrieved investors, Hong Kong does not have class action rights under which the investors can sue collectively. It became an onerous burden for individual investor to bring an action in Hong Kong. In the view that contingency fees arrangement may be helpful, investors turned to a U.S. law firm who would represent them in a class action in New York to recoup HK\$1.53 billion. Seven plaintiffs in Hong Kong and the US filed the action, contending that HSBC (USA) had failed to protect the interests of the investors by redeeming the collateral — securities now being held by both HSBC and Bank of New York Mellon Corpt, and is therefore in breach of their duties as a trustee.²³ That said, it was estimated that the waiting time for trial would be 3 years and 18% of the remedy sought would be deducted for legal fees.²⁴

The Buy-Back Proposal

Apart from the litigation route, the Hong Kong Association of Banks had once accepted the Government's proposal of buying back the mini-bonds from the investors, which will be priced based on its estimated current value. However, the plan was halted due to legal technicalities. In November 2008, the banks received from the trustee (HSBC) a letter from the legal advisers of Lehman Brothers in the US addressed to the trustee (HSBC). Claims in that letter include that the proceeds from any sale of the underlying collateral for the mini-bonds should be paid to Lehman Brothers before the issuer of the mini-bonds and in turn the investors. This claim is said to be contrary to the express terms of the mini-bond documents, but if upheld, this will significantly reduce the value of the mini-bonds. Due to the complexities of the legal issues involved and the uncertainties surrounding their outcome, the banks have therefore decided to continue the buy-back only after these legal issues have been clarified and the market value can be determined.²⁵

²² Siu Beatrice, "Minibond investors fear move spells end for claims", *The Standard*, 24 March 2009

²³ Agencies, "Hong Kong investors sue US banks over Lehman losses", *The Economic Times*, 15 March 2009

²⁴ "Lehman Brothers Suit in US will be filed in Weeks" *Ming Pao News*, 4 February 2009

²⁵ Press release, "Latest Developments regarding buy-back of minibonds", Hong Kong Association of Banks, 17 December 2008 (accessed at: http://www.hkab.org.hk/asp/public/news.asp?Submit=Detail&lan=en&id=NS_0000058)

The ongoing saga of Lehman Brothers has serious repercussions for the banking industry. Not only investors' sentiments have become hostile towards wealth management products, forcing the banks to return to more traditional but competitive mortgage business, the prolonged conflicts would also lead to the need for extra manpower for the banks to deal with complainants and the regulator, increase legal and consulting costs, and reduce intangible assets value such as goodwill. Investors demonstrating outside the bank's building will also have adverse impact on the bank's daily operation. The escalation of dispute gives rise to a need for political interventions which may result in demands not in the best interests for the banks and its shareholders. These factors have worsened the unfavourable business environment of the banks created by the financial crisis. Sharp plunges of stock price of major publicly listed banks were observed.

The Mediation Scheme

On 31 October 2008, the HKIAC was appointed by the HKMA to be the service provider for the Lehman Brothers-related Investment Products Disputes Mediation and Arbitration Scheme ("the Scheme"). The purpose of the Scheme is to provide a dispute resolution platform for the resolution of disputes between investors and banks in Lehman Brothers-related investment products. The role of the HKIAC is to provide Mediation and Arbitration services to investors and banks.²⁶

The Scheme is available to qualified candidates under which the HKMA will pay half the fee and the bank concerned the other half.²⁷ To qualify, an investor has to have made a complaint to the HKMA and the HKMA reviewed it and referred it to the SFC for consideration; or either the HKMA or the SFC has made a finding against the bank or bank officer concerned.²⁸

Key features of the Scheme²⁹

(1) A special hotline ((852) 8100 6448) has been set up to handle all enquiries in relation to the Scheme. Since the Scheme Office does not proactively solicit cases for the convening of mediation, the hotline is the only channel vital for the banks and investors to initiate mediation. Hence, staff members are trained in basic mediation

²⁶ Press Release, "Lehman Brothers-related Investment Products Dispute", Hong Kong International Arbitration Centre, 31 October 2008

²⁷ The fee for mediation is HK\$5600 per party and the fee for arbitration is HK\$8100 per party; the duration of mediation is 5 hours.

²⁸ Press Release, "HKMA announces mediation & arbitration services for Lehman Brothers-related cases", Hong Kong Monetary Authority, 31 October 2008

²⁹ Press Release, "Mediation 100% Success for Lehman Brothers-Related Investment Product Cases", Hong Kong International Arbitration Centre, 19 February, 2009

knowledge in order to accurately explain the essence of mediation to the investors and to invite them to a pre-mediation briefing session. A mediation tool book is given to every staff member in the Scheme Office to allow them acquire further understanding of the mediation process and facilitate case management. Most of the inquirers found the information provided by the hotline staff useful and 50% of the qualified investors chose to attend the pre-mediation briefing session.

(2) Pre-mediation briefings are conducted with individual banks and investors during which a practicing mediator would discuss the suitability of mediation with regard to specific case. The pre-mediation session help disputants make informed decision as to whether to mediate. Through the session, the disputants can understand the rudimentary knowledge of mediation, its functions and limitations and be able to distinguish mediation from other adversarial means of dispute resolution. The session is crucial to the Scheme as it is very important for the parties to bring to mediation an appropriate mindset for settlement. Parties not ready for mediation would be screened to enhance successful rate. 78% of the disputants attending the briefing session agreed to use mediations service provided by the scheme.

(3) Preparation meetings are conducted before mediation takes place. The preparation serves two purposes. First, a mediator other than the one who would serve as the neutral in the actual mediation would act as a mediation advocate to prepare the investor for negotiation. Since most of the investors are of low education level, and do not have experience in mediation or formal negotiation before, it is necessary to improve their psychological quality and to familiarize them with the mediation process. Second, each mediation session will last for a maximum of five hours. If the parties are dragged into hostile arguments, there would not be sufficient time to explore settlement options. Hence, it would be helpful for the mediation advocate to coach the parties in using interest-based negotiation and to reinforce the voluntary and amicable nature of mediation.

(4) The Scheme Office will also facilitate the parties in exchanging information and documents. It makes easier for the mediator to devote himself understanding the interests and needs of the parties - banks may have a need to manage risks, minimize political impacts, maintain reputation and strengthen client relationship; whilst investors may have pressing cash-flow problems, or loans or medical expenses to be paid. By setting aside legal arguments, mediators can help parties explore settlement option including but not limited to the “buy-back” of the minibonds. and/or other *ex gratia* offers such as

medical allowances to the elderly or counseling service to help investors cope with pressure due to the sudden and huge financial loss, reduction in mortgage loan interests, or even making donation to charitable organizations.³⁰

The Interim Result of the Scheme

According to the announcement of the HKIAC, a total of 149 requests for mediation have been made under the Scheme as of 24 March 2009. The amounts involved range from some HK\$40,000 to over HK\$ 5 million in each individual case. Some 20 cases have been settled by direct negotiations between the investors and the banks after mediation was requested. In 17 other cases mediation proceeded and in all of these cases settlement agreements were concluded. This means that the Scheme's success rate so far is 100%. All of the mediation sessions, which took place within 1 week of the appointment of the mediators, were concluded within 5 hours. Post-mediation interviews revealed that the parties were satisfied with the usefulness of the mediation process and the professional performance of the mediators.³¹

Benefits to the Banking Corporations

The Mediation Scheme benefits the banking industry in several ways. The most direct benefit is to obtain full and final settlement of the dispute and to avoid further escalation of dispute to a full blown litigation. Protected by the confidentiality of mediation, sensitive information remains undisclosed. Long term relationships with customers are maintained and this would be in the best interests of the banks' shareholders.

The cost of mediation is low compared to other alternative means of dispute resolution and the process takes only 5 hours. Both management time and legal costs are saved. Moreover, banks can spend fewer resources in dealing with disputes and hostile demonstrations. It would be more desirable for the banks to spend more time developing their business rather than dealing with endless disputes.

(2) The New Insurance Mediation Pilot Scheme (NIMPS)

The insurance industry is one of the sectors being severely hit by the financial crisis. It is best illustrated by the liquidity crisis of the American International Group (AIG), the largest insurance group in USA, which has eventually triggered a wave of policy termination

³⁰ Tan, Oscar, "There's more to mediation than talking", *The Standard*, 22 October, 2008

³¹ Press Release, "Mediation 100% Success for Lehman Brothers-Related Investment Product Cases" Hong Kong International Arbitration Centre, 19 February, 2009

in Hong Kong.³²

By its very nature, the insurance industry is also dispute-intensive. In 2008, the number of complaints in relation to insurance claims has increased by 19.8% increase over the previous year of which the first three largest categories of claim disputes are hospitalization/medical, life/critical illness and personal accident/disability insurance claims.³³ Litigating insurance claims is costly and the legal costs amount to an estimate of 40% of the claim in question.

To resolve insurance claims in personal injury cases, the Hong Kong Federation of Insurers (HKFI) has taken initiative in seeking alternatives to litigation. In 2006 the HKFI had granted a sum of HK\$250,000 to fund a pilot mediation project –NIMPS, operated by the Hong Kong Mediation Council. The objective of NIMPS is to encourage amicable, economical and objective settlement of personal injuries claims between insurance companies and the injured workers.

The new insurance mediation pilot scheme is not a recent development but the progress on the former Insurance Mediation Pilot Scheme.³⁴ However, the take up rate of the old scheme was nil. Both the insurance companies and the claimants are not familiar with mediation and are reluctant to give mediation a trial. In order to resolve this perceived reluctance, a working group consisting of representatives from the insurance industry, Hong Kong Mediation Council, the Labour Department and Hong Kong Workers' Health Centre has been formed to oversee the project.³⁵

After much hard work by various parties, the first mediation case under the scheme was successfully settled in March 2007.³⁶ Another successful case was recorded in July 2008.³⁷ Following the drawing up of this report on how the scheme and the mediation process could be improved, members of NIMPS and the HKFI have held meetings with the Judiciary working party reporting on the pilot case. The effect of NIMPS is that with the new civil procedure rules coming into effect on 1 April 2009, there will also be new practice directions on the use of mediation for cases on the personal injury list.³⁸

³² Agencies' News, "More than 1,500 AIG policies terminated in Hong Kong: Report", *The Economic Times*, 17 September 2008

³³ Statistics, The Insurance Claims Complaints Bureau, 1 January 2008 – 31 December 2008 (accessed at: http://www.iccb.org.hk/en_statistics.htm)

³⁴ *Annual Secretary-General Report for 2002-2003*, Hong Kong International Arbitration Centre, 16 December 2003

³⁵ *Annual Report 2006-07*, Hong Kong Federation of Insurers, at p.14

³⁶ Barrington, L "Slowly but Surely...Mediation Goes Mainstream in Hong Kong", *Hong Kong Lawyer*, March Issue 2007

³⁷ Wong K, "A Better Way of Ending Dispute: Can Employees' Compensation Cases and Personal Injury Claims be Resolved Through Mediation?", *The HKey*, Kennedys, Winter 2008

³⁸ Practice Direction 18.1, Judiciary at [14], [28-29] (accessed at: http://legalref.judiciary.gov.hk/doc/whats_new/prac_dir/html/PD18.1.pdf)

Mediation not only helps injured workers claim monetary compensation, it can further reduce workers' worries about long-term livelihood by providing an opportunity for the employer, as part of the settlement, to offer the injured worker an alternative post in the company or put him on light duties until he is physically able to work at full strength again. It had brought about mutual satisfaction of both parties than any of the traditional dispute resolution mechanisms.

(3) Court-connected Building Management Mediation

Building management is an area which by its nature cries out for the use of mediation. It is particularly true in Hong Kong where the high-rise buildings are densely populated and the neighbours not well acquainted to each other despite living in close proximity. Disputes emerged under such environment are usually complicated by multiple parties and issues charged with strong emotions. Court actions often cause delay in the daily management activities of the building and worsen the relationship between parties. Building management companies normally need to invest a large amount of time dealing with disputes among individual owners and of the Owners Corporation, which is a costly and labour-intensive exercise. In time of recession, such drawbacks are significant.

In the view that mediation could help resolve complex and multi-party building management disputes, a Practice Direction on a Pilot Scheme for Building Management Cases (the Building Management Pilot Scheme, "BMPS") was issued by the President of the Lands Tribunal in September 2007.³⁹ The Direction has expressly spelled out the aim behind the BMPS, being to improve the efficiency and expedite the fair disposal of building management cases before the Lands Tribunal.⁴⁰

The BMPS encompasses the use of mediation, though it is primarily limited to cases in which parties are legally represented. However, cases which the Presiding Officer deems fit may also be assigned to the Pilot Scheme list. The Direction encourages parties to consider the early resolution of their disputes prior to, and after, filing their claim.⁴¹

To facilitate the use of mediation, a Mediation Coordinator's Office (MCO) was established in the Lands Tribunal. The MCO will provide information on mediation to interested parties whose proceedings are going to be commenced, or have already begun.

³⁹ Direction on "Pilot Scheme for Building Management Cases (LTPD : BM No. 1/2007), Lands Tribunal, (accessed at: http://www.judiciary.gov.hk/en/crt_services/pphlt/pdf/ltpd_bm_no1_2007.pdf)

⁴⁰ Direction on "Pilot Scheme for Building Management Cases (LTPD : BM No. 1/2007), Lands Tribunal, (accessed at: http://www.judiciary.gov.hk/en/crt_services/pphlt/pdf/ltpd_bm_no1_2007.pdf) at [2]

⁴¹ *Ibid.* at [12]

MCO will also maintain a list of accredited mediators who are available to mediate disputes.

Another aspect of the Direction stipulates that parties who unreasonably fail to make a good faith attempt to mediate may face adverse costs consequences. In this regard, the Direction requires that in building management cases the parties' lawyers advise their clients of the cost implications of litigation and the principles on adverse costs for unreasonable refusals to attempt mediation.⁴²

Notwithstanding the usefulness of the Pilot Scheme, its effect is limited by the number of building management cases actually escalated to the Lands Tribunal.⁴³ The majority of the disputes remain at the community level and to be dealt with by the building management companies. Hence, mediation programs similar to that of the court-connected Pilot Scheme are yet to be established and institutionalized within the community to deal with the majority of building management disputes in a cost and time-saving manner.

(4) Court-Connected Shareholders' Dispute Mediation

From October 2008 onwards, parties in shareholders' dispute would be encouraged to consider the use of mediation under the new Practice Direction 3.3 issued by the Chief Justice of Hong Kong.⁴⁴ This Practice Direction provides for a pilot scheme to operate for a period of one year in respect of petitions presented under section 168A – unfair prejudice to minority shareholders⁴⁵; or petitions for winding up on the just and equitable ground under section 177(1)(f)⁴⁶ of the Companies Ordinance (Cap. 32)

The Practice Direction is applicable where the petitions are purely disputes between shareholders, not involving the interest of the general body of creditors of the subject company or affecting the public interest and there is no allegation of insolvency concerning the subject company and no allegation that the affairs of the company would require full investigation in the public interest.⁴⁷

Under the pilot scheme, mediation can be initiated at any stage of the petition by serving

⁴² *Halsey v Milton Keynes NHS Trust* [2004] 1 WLR 3002 at [13], [16] – [30]

⁴³ See "Hong Kong Judiciary Annual Report", Judiciary, 2008, average caseload for 2006-2008 is 388

⁴⁴ Practice Direction 3.3, Judiciary, at [1] (accessed at: <http://legalref.judiciary.gov.hk/lrs/common/pd/pdcontent.jsp?pdn=PD3.3.htm&lang=EN>)

⁴⁵ Subsection (1) provides that "any member of a specified corporation who complains that the affairs of the specified corporation are being or have been conducted in a manner unfairly prejudicial to the interests of the members generally or of some part of the members (including himself)...the Financial Secretary, may make an application to the court by petition for an order under this section."

⁴⁶ S177(1)(f) provides "[A company may be wound up by the court if] the court is of opinion that it is just and equitable that the company should be wound up".

⁴⁷ Practice Direction 3.3 at [2], see note 42

a notice ("a Mediation Notice") on the other party or parties ("the Respondent"), inviting them to agree to mediation, utilizing a standard format prescribed in the Practice Direction.⁴⁸

Where the parties could not agree to the proposed mediation to resolve the whole or part of the dispute, he should state in the response why he does not believe such proposed mediation to be appropriate, and be prepared to justify his refusal to attempt mediation at the conclusion of the trial. Unreasonable refusal would again lead to cost sanction. That said, the parties may apply to a Companies Judge for a ruling where, they are unable to resolve their difference on a point of procedure or mechanics concerning the proposed mediation; or they are unable to agree on the minimum level to qualify as sufficient participation in the proposed mediation.⁴⁹

Such mediation is seen to be effective in resolving intra-company disputes. Shareholders' and workplace conflicts, if developed into full-blown disputes, can at best lead to poor performance, and at worst paralyzing a company. Companies in Hong Kong, mainly family-controlled, are vulnerable to such risks. (See Wong To Yick Wood Lock Ointment Ltd and Wong To Yick v Wong Tin Chee Tinly and others⁵⁰).

The court mediation scheme can help minimize the risks associated with shareholders' conflicts. First, family disputes and squabbles can be dealt with in a private and informal manner. Second, solutions can be customized to take into account the needs of other family members who are not directors or employees of the company. Moreover, the emotional content in shareholder disputes can be sensitively handled by mediation. Instead of obtaining share purchases order from the court which can be blunt and undesirable, relationship problem and commercial problem can be disentangled in a creative manner in mediation.

(5) Hong Kong Mediation Commercial Mediation Pilot Scheme (CMPS)

The Hong Kong Mediation Council has also been actively providing mediation pilot schemes through its sub-committees *viz.* the Commercial Mediation Committee, the Family Mediation Committee, the Construction Mediation Committee, and the Community Mediation Committee. The Commercial Mediation Committee has recently established the Commercial Mediation Pilot Scheme (CMPS), and the Construction Mediation Committee has recently re-launched its Pro-bono Mediation Pilot Scheme for the Construction Industry, another sector which normally suffers large cut-backs under the economic recession.

The CMPS was launched on 1 July 2007. It caters to commercial disputes of a wide

⁴⁸ *Ibid.* at [3-4], see note 42

⁴⁹ Practice Direction 3.3 at [8], [16], see note 42

⁵⁰ [2007] HKEC 472

nature including international business disputes. There is no cap on the amount in dispute that may be mediated and the mediators would charge on a 'reduced-fee basis', in essence HK\$1000 per hour and shared equally between the parties. The mediation of disputes is required to be completed within 30 days following an initial request for mediation. The administration of the CMPS is by volunteer members of the Commercial Mediation Committee and HKMC members who wish to mediate under the scheme.⁵¹

Compared to other jurisdictions, however, the use of mediation should not be confined to resolving disputes in small family-owned businesses. In fact, many Fortune 500 companies such as Motorola, General Electric and Brown & Roots have established in-house dispute resolution systems to deal with workplace and commercial disputes. Such systems have cut litigation costs for as much as 75% in six years.⁵²

In fact, mediation used in conjunction with arbitration has proven to be effective in resolving contractual disputes in Hong Kong. Whilst parties can enjoy self-determination in mediation, the settlement agreement can be turned into an arbitral award for enforcement. If no settlement is reached during mediation, the parties can resort to the arbitral tribunal to resolve disputes with finality. The Hong Kong Airport Core Project in 1992-1997 had successfully implemented such system with the fact that most contractual disputes were settled in the first mediation tier.

CONCLUSION

Contract in its meaning include trust, mutuality and meeting of the minds. There is no reason why parties cannot have an upfront meeting at the beginning of a dispute, to encourage collaborative problem-solving in order to achieve agreed goals. With the help of a mediator, parties can build and reinforce relationship based on trust and mutuality instead of having litigation and adversarial communication add fuels to the dispute.

Failed contracts and anticipatory breach are common during economic recession, but parties may be reluctant to initiate mediation because such initiation can be perceived as a sign of weakness. In order to avoid this perception, companies in USA have signed an ADR pledge in which they agreed to explore mediation at times of a dispute. When a dispute arises, these companies will activate the pledge as a matter of policy and involve neutrals at an early stage to sort out problems. Generally 80% of the cases mediated are settled, some within a few days.

⁵¹ Terms of Reference of the CMPS (accessed at: <http://www.hkiac.org/HKIAC/pdf/Mediation/Commercial%20Mediation%20Pilot%20Scheme%20TOR%20v2.6.pdf>)

⁵² Slaikeu, K. A., and Hasson, R. H. *Controlling the Costs of Conflict: How to Design a System for Your Organization*. San Francisco: Jossey Bass, 1998.

Apart from dealing with crisis on an ad hoc basis, mediation has not been generally accepted as a standard operating procedure for the resolution of commercial disputes in Hong Kong. The emergences of mediation schemes in different sectors as well as the civil justice reform to be effective from April 2009, however, have provided an opportunity for company's management to seriously consider using mediation and other problem-solving mechanisms to implement and enforce good corporate governance practice, improve shareholder protections, as well as turning failed contracts to new business opportunities. More importantly, corporations can avoid costly and timely lawsuits and focus their efforts in improving investor confidence and the company's performance during the recession.