Mediation in disputes arising in the context of enforcement of security interests

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1. Introduction

Mediation has become an important method for the resolution of both national and international commercial and non-commercial disputes. This is undoubtedly due to its unique characteristics. While by and large mediation is essentially a voluntary method of resolving disputes, many jurisdictions have adopted laws that require parties to submit their disputes to mandatory mediation before litigation.[1] Mediation is used in wide range of disputes including family, consumer, public policy, tort, environmental, employment, bankruptcy, securities regulation, banking, and between farmers and lenders.[2] The UNCITRAL Model Law on International Commercial Conciliation in 2002 has promoted mediation to be widely recognised around the world as an effective dispute resolution method.[3] Recently, the UNCITRAL's work in this field has been extended to the preparation of an instrument dealing with the enforcement of international commercial settlement agreements resulting from conciliation.[4] As a reflection of mediation's flexible nature, transnational secured transactions law texts that aim to modernise domestic secured transactions laws have also recognised the use of alternative dispute resolution (ADR) mechanisms (including mediation) in the enforcement of security interests.[5] At its 49th session the UNCITRAL Commission decided that, among others, 'the question whether disputes arising from security agreements could be resolved through ADR mechanisms' should be considered.[6]

This article takes a novel approach to analyse the key question whether it is possible to include third parties in the mediation of enforcement related disputes and if so how should

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[1] For a comparative analysis of mediation laws of selected jurisdiction *see e.g.* K. Hopt and F. Steffek (eds), *Mediation: Principles and Regulation in Comparative Perspective* (OUP, 2013); particularly *see* Hopt and Steffek, 'Mediation, Comparison of Laws, Regulatory Models, Fundamental Issues' in Hopt and Steffek (eds) 3, 22 *et seq;* N. Alexander, 'Harmonisation and Diversity in the Private International Law of Mediation: The Rhythms of Regulatory Reform' *in* Hopt and Steffek (eds) 131, 187 *et seq.*; L. Rozdeiczer and A. A. de la Campa, 'Alternative Dispute Resolution Manual: Implementing Commercial Mediation' (IFC/World Bank Group, 2006)

[2] For more details *see* S.R. Cole, C.A. McEwen and N.H. Rogers, *Mediation: Law, Policy & Practice* (2nd ed., West, 2010), ch. 12; M. McIlwarth and J. Savage, *International Arbitration and Mediation A Practical Guide,* at 175 (Kluwer 2010) arguing that mediation is 'a tool that may be suitable for *any* dispute that a party wishes to attempt to settle). *See also generally* Hopt and Steffek, *ibid.*

[3] http://www.uncitral.org/pdf/english/texts/arbitration/ml-conc/03-90953_Ebook.pdf (accessed January 2017). 16 states in 28 jurisdictions have based on or been influenced by the Model Law. http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/2002Model_conciliation_status.html (accessed January 2017). For the work of the UNCITRAL on mediation *see e.g.* N. Alexander, 'UNCITRAL and International Mediation' in *International and Comparative Mediation, Global Trends in Dispute Resolution* in N. Alexander (ed.) 337 (Kluwer, 2009).

[4] A/CN.9/WG.II/WP.187; A/CN.9/WG.II/WP.190; A/CN.9/WG.II/WP.200.

[5] *See e.g.* OAS Inter-American Model Law on Secured Transactions; UNCITRAL Legislative Guide on Secured Transactions; UNCITRAL Model Law on Secured Transactions.

[6] A/71/17, paras 125, 96-98. *See* A/CN.9/871, paras. 83-86, and A.CN.9/885/Add.3, paras. 55 and 58; A/CN.9/836, paras 48-53.

this procedure be, and whether grantor and secured creditor's settlement agreement (or mediated agreement) as a result of the mediation process may have an impact on the rights of third parties. The central argument point of this article is that the use of mediation in enforcement related disputes positively affect the availability and cost of credit and that the parties to a secured credit agreement have the freedom to agree on the enforcement procedure, but that this choice should not have any adverse effects on third party rights. This is particularly true given the fact that mediation is a confidential and a non-transparent method of dispute resolution and that third parties cannot be joined unless all parties consent to this joinder. Therefore, a system that responds to both of these concerns should be established.

The article begins in part 2 by summarising the characteristics of mediation. It discusses the nature of mediation only between parties to the dispute. It then provides a sketch of the question of using mediation in enforcement of security interests. Part 3 analyses the impact of mediation in the context of enforcement of security interests. It examines the problems of third parties in the enforcement process and provides examples of use of mediation in the post-default process from different jurisdictions as well as from the transnational texts perspective. It also examines whether third party rights are protected in the event of a settlement agreement and finally what would a readiness to enable the use of mediation in enforcement related disputes tells us about the contours of the market order we are creating. Conclusions will be in Part 4.

2. The Nature and Characteristics of Mediation and its possible use in the enforcement of security interests

Mediation has been widely used for centuries and was an important method of dispute resolution method in Ancient Greece, Ancient Egypt, China (due to Confucianism)[7] and India.[8] Mediation was used as a conflict prevention method in the Jewish tradition.[9] Its use in commercial and industrial relations gained significance in the 18th and 19th century England due to the increased complexity of life and litigation procedures as well as the problems introduced by urbanisation.[10] ADR as used under the UNCITRAL Model Law does not exclusively mean mediation or conciliation. It encompasses other dispute resolution mechanisms which are not classified as litigation. Other alternative dispute mechanisms include arbitration, negotiation, mediation/arbitration (med-arb), early neutral evaluation and expert determination. Mediation is an ADR mechanism where a mediator 'works with the parties to resolve their dispute by agreement, rather than imposing a solution.'[11]

Mediation and *Conciliation* have been interchangeably used in practice. The UNCITRAL Model Law on International Commercial Conciliation does not make a distinction between

[7] E.S. Reinstein, 'Finding a Happy Ending for Foreign Investors: the Enforcement of Arbitration Awards in the People's Republic of China' 16 *Indiana International and Comparative Law Review* 37 (2005); for a detailed analysis of mediation's history *see* C. Menkel-Meadow, 'The Future of Mediation Worldwide: Legal and Cultural Variations in the Uptake of or Resistance to Mediation' in Essays on Mediation: Dealing with Disputes in the 21st Century, Global Trends in Dispute Resolution, v. 6, I. MacDuff (ed.), 29 (Kluwer, 2016).

[8] S. Greenberg, C. Kee, J.R. Weeremantry, *International Commercial Arbitration: An Asia-Pacific Perspective,* 3 *et seq* (CUP, 2011).

[9] *See* G.M. Steinberg, 'Conflict Prevention and Mediation in the Jewish Tradition' 12 *Jewish Political Studies Review* 3 (2000).

[10] *See* P. Brooker, *Mediation Law: A Journey through Institutionalism to Juridification* (Routledge, 2013); A. J. Woolford and R. Ratner, *Informal Reckonings: Conflict Resolution in Mediation, Restorative Justice and Reparations* (Routledge, 2008). For similarities between equity and mediation *see* J.M. Nolan-Haley, 'The Merger of Law and Mediation: Lessons from Equity Jurisprudence and Roscoe Pound' 6 *Cardozo Journal of Dispute Resolution* 57 (2004).

[11] J. Lew, L. Mistelis and S. Kroll, *Comparative International Commercial Arbitration*, 13 (Kluwer, 2003).

mediation and conciliation.[12] In mediation, the mediator, a neutral person, merely facilitates communication between two parties and offers solutions proactively without imposing solutions. Mediation may take different forms. If the mediator, without disclosing her opinion on the merits, is merely attempting to facilitate the communication between the parties with a view to clarify the issues between them so that they can re-evaluate the legal positions, this mediation is said to be a *facilitative* mediation. If the mediator is providing directions and evaluating the merits of the case, this is an *evaluative* mediation. The latter type is in its nature closer to conciliation. In conciliation, on the other hand, conciliator plays a direct role in the actual resolution of the dispute by advising parties and making proposals.[13] Conciliator offers the best solution, whereas the mediator is truly impartial and neutral.

Mediator's intervention in the parties' disputes may involve in a number ways. In each of the following methods, the rationale is to facilitate the communication between two parties who cannot communicate with each other with a view to reach an amicable solution. The mediator may (a) act as a messenger between the parties; (b) act as a 'mutual confidant' by listening to parties' differences with a view to achieve a meeting between the parties; (c) act as an evaluator of one or both parties' positions; or (d) encourage parties to reach a settlement on certain terms.[14] Mediator assists parties to resolve their disputes, but, unlike arbitration, does not impose a solution on the parties.[15] If the parties have a long term commercial relationship, this relationship is not affected by prolonged litigation or arbitration hearings which may have winners and losers. The severed communication between the parties may not be established in adversarial methods. Also the transparent nature of court decisions and arbitral awards (in the enforcement process) may affect the confidential nature of the dispute, hence preference of mediation. Furthermore, the private and confidential character of mediation provides an atmosphere which enables parties to be more candid about their positions. In order to protect the confidential information that is necessary to reach a mutually acceptable agreement, the mediator may employ different methods. A significant strategy is that where mediator meets with parties separately. These private meetings are called the *caucuses*. These meetings are necessary to make the parties more comfortable, and to learn their priorities and interests. This is also an appropriate method when there are multiple parties in mediation.

Mediation offers a private decision making process. It is regarded as an alternative to arbitration which is a private binding adjudication mechanism and to litigation which is a public binding adjudication mechanism.[16] Unlike litigation, mediation is a consensual, voluntary and non-binding method of dispute resolution. Parties agree to submit their

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[12] Article 1(3).

[13] *See* UNCITRAL Conciliation Rules article 7(1) "The conciliator assists the parties in an independent and impartial manner in their attempt to reach an amicable settlement of their dispute."

[14] *See* Andrews, above *note* 11, 188-189. Some of the functions of the mediator may be listed as follows: encourage parties to exchange information, providing new information, assist parties to understand each other's position and views, ensure that their concerns are understood by both the adversaries and the mediator, ensure that parties assess their alternatives realistically before agreeing to settle, focus to the future in order to establish better relationships, help parties to reach creative settlements, learn parties' interest in separate meetings [caucuses] to invent mutually agreeable solutions. For more details on these *see* S.B. Goldberg, F.E.A. Sander, N.H. Rogers and S.R. Cole, *Dispute Resolution Negotiation, Mediation and other Processes* 107 *et seq.* (Kluwer, 5th ed., 2007).

[15] Some of the functions and role of the mediator are: 'getting participants to talk to each other, setting the agenda, helping disputants understand their problems, and suggesting possible solutions.' *See* T. B. Carver and A. A. Vondra, 'Alternative Dispute Resolution: Why it doesn't work and why it does?' *Harvard Business Review* 120, 122 (May-June 1994).

[16] In England, for instance, civil litigation has three alternatives: party-to-party negotiation, mediation or conciliation, and arbitration. For a detailed discussion of access to justice and mediation *see* N. Andrews, *The Three Paths of Justice Court Proceedings, Arbitration, and Mediation in England* (Springer, 2012), ch. 9.

disputes to mediation on a consensual and voluntary basis. This is regarded as one of the main characteristics of mediation that distinguishes it from litigation.[17] While litigation and court decisions may be public, mediation process remains confidential and lacks transparency. During the enforcement and recognition of arbitral awards, arbitration becomes transparent (though the award may still not be public).[18] Unlike a judge, the mediator does not have coercive powers to be able to summon parties to the mediation table. Thus the consent of the parties is necessary to include third parties. This is similar to arbitration where joinder of additional parties is concerned.[19] Thus, parties may often prefer to combine mediation with arbitration. Such approach to dispute resolution enables parties to ensure that if one method of dispute resolution fails, parties may be able to fall back to the next agreed dispute resolution mechanism.[20] Advantages of mediation, in the context of cost of enforcement of legal rules in general, include reduction of backlogs in the court system, reduction of the time required for the enforcement of contracts, saving time and cost in dispute resolution for parties, resolution of complex multiparty disputes in an efficient way by experts, achieving access to justice for disadvantaged groups such as illiterate and poor and reduction of tension between long term business partners.[21]

In the United Kingdom, courts have supported the use of mediation.[22] While parties may be required to pursue mediation (simply the law in that jurisdiction may require them to do so or the risk that their claims may be dismissed later in a court of law are the two significant reasons why mediation clauses may be enforceable)[23] or compelled to accept a settlement, they may abandon the process at any time if they do not feel the outcome is feasible and pursue other remedial options.[24] This denotes the voluntary and non-binding nature of mediation. There are, however, examples where the state legislation requires parties to pursue mediation before bringing their disputes to litigation which may, somewhat, be inconsistent with the voluntary nature of mediation.[25] The rationale of this approach is to achieve

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[17] For further details *see* Cole, *et al.,* above *note* 2. This is also the case under the European Directive on Mediation (2008) Preamble paragraph 13 which reads as follows:

> "The mediation provided for in this Directive should be a voluntary process in the sense that the parties are themselves in charge of the process and may organise it as they wish and terminate it at any time. However, it should be possible under national law for the courts to set time-limits for a mediation process. Moreover, the courts should be able to draw the parties' attention to the possibility of mediation whenever this is appropriate."

Directive 2008/52/EC of the European Parliament and of the Council of 21 May 2008 on certain aspects of mediation in civil and commercial matters. For more information on the European Directive on Mediation *see* Association for International Arbitration (ed.) *The New EU Directive on Mediation First Insights* (Maklu, 2008).

[18] Except in the case of investment arbitrations where decisions are published on the ICSID website *see* https://icsid.worldbank.org/en/Pages/cases/ConcludedCases.aspx?status=c (accessed January 2017)

[19] For an in-depth analysis of consent and third parties in arbitration *see e.g.* S. Brekoulakis, *Third Parties in International Commercial Arbitration* (OUP, 2011).

[20] *E.g. Cable & Wireless v IBM United Kingdom Ltd*. [2002] 2 All ER (Comm) 1041. While in this case, the High Court has found that parties should continue with the mediation stage of the multi-tiered dispute resolution clause, it is possible, however, that the court may regard the futile nature of ADR in a particular type of dispute, in which case, one party's application might be accepted. The statute may also prevent any opt out mechanism from applying to court directly. *Clyde & Co v Bates van Winkelhof* [2011] EWHC 668(QB). For the analysis of these cases *see* Andrews, above *note* 11, at 201-202.

[21] Rozdeiczer and de la Campa, above *note* 1, at 11-12.

[22] *See e.g. R (Cowl) v Plymouth City Council* [2001] EWCA Civ 1935, [2002] 1 WLR 803; *Dunnett v Railtrack plc* [2002] EWCA Civ 303, [2002] 1 WLR 2434; *Hurst v Leeming* [2001] EWHC 1051 (Ch), [2003] 1 Lloyds Rep 379.

[23] For a detailed discussion *see e.g.* Cole *et al.,* above *note* 2, §§8.2-8.4.

[24] Parties may be compelled to pursue mandatory mediation and may be pressurised into a settlement. For further details *see* Cole *et al*, above *note* 2, at ch. 7.

[25] In Colombia, mediation is a prerequisite before litigation in commercial cases. *See* S. Poguet, 'Arbitrating and Mediating Disputes Benchmarking Arbitration and Mediation Regimes for Commercial Disputes Related to

efficiency in the resolution of commercial disputes.[26] That is that mediation provides opportunities to put the parties' dispute into context, thus enable them to resolve their disputes more effectively. The European Directive on Mediation suggests that there may be national legislation making mediation compulsory, compelling parties to submit their disputes to mediation before using the judicial system.[27] In most European jurisdictions court referral to mediation is largely a voluntary action.[28]

Authors[29] who advocate mediation have forwarded views that courts mainly provide a service (rather than a location) and that there is a necessity for the distribution of dispute resolution services in order to reduce the burden on courts. Thus, private dispute resolution mechanisms such as mediation have been regarded as parallel to centralised and specialised institutions (i.e. courts). It has also been argued that courts' function is merely settlement rather than adjudication.[30] However, these views somehow contradict with law the 'complexity, function, and consequence' of which depend on its argumentative nature.[31] Law is based on clear theoretical underpinnings and lack of theoretical underpinnings of mediation[32] has been defended from the perspective that it has a facilitative role which empowers parties and acts as a device for social transformation.[33] This is where the critiques of mediation forward a number of justifiable counter-arguments. Dame Hazel Genn argues that the fact that mediator does not adjudicate or make a decision on the quality of the outcome and settlement leads to the reality that success is about 'a settlement that the parties can live with.'[34] Thus parties have to realise the legitimacy of their different perspectives. And this requires a culture of justice through law and accepting fairness and acceptable outcomes. Criticism has also been directed at the courts' dual role to assist the parties to settle and adjudicate their disputes. Nolan-Haley argues in relation to court mediation that the civil

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Foreign Direct Investment' *Policy Research Working Paper, The World Bank, Financial and Private sector Development Network, Global Indicators and Analysis*, p. 9 (2013).

[26] For example, recently in Scotland parties to a commercial dispute are encouraged to "consider carefully and discuss whether some or all of their disputes may be amenable to some form of alternative dispute resolution." (Paragraph 11) https://www.scotcourts.gov.uk/docs/default-source/rules-and-practice/practice-notes/court-of-session/court-of-session---practice-note---number-1-of-2017-(commercial-actions).pdf?sfvrsn=4 (accessed March 2017).

[27] European Directive on Mediation (2008) Preamble paragraph 14.

> "(14) Nothing in this Directive should prejudice national legislation making the use of mediation compulsory or subject to incentives or sanctions provided that such legislation does not prevent parties from exercising their right of access to the judicial system. Nor should anything in this Directive prejudice existing self-regulating mediation systems in so far as these deal with aspects which are not covered by this Directive."

[28] G. de Palo and M. B. Trevor (eds) *EU Mediation Law and Practice* (OUP, 2012). Belgium (referral to mediation is by and large a voluntary action) at 20-21, Austria (under very limited conditions the judge may refer parties to mediation) at 12, France (if the judge has obtained the consent of the parties) at 115-116, Italy (the judge cannot require parties to attend mediation sessions) at 190, Spain (the court may invite parties to mediation) at 330, United Kingdom (referral is voluntary) at 379-381. *But cf.* Germany (court-annexed or court-based mediation is part of daily court work where the settlement agreement becomes enforceable as a court decision) at 133.

[29] E.g. *see generally* R. Susskind, 'Foreword', *Online Dispute Resolution: Theory and Practice - A Treatise on Technology and Dispute Resolution,* in M.S. Abdel Wahab, E. Katsh and D. Rainey (eds), p. v (Eleven Law, 2012).

[30] D. de Girolamo, *The Fugitive Identity of Mediation: Negotiations, Shift Changes and Allusionary Action*, 6 (Routledge 2013).

[31] *See* R. Dworkin, *Law's Empire,* 13, (Harvard University Press, 1986).

[32] As argued in L. Fuller, 'Mediation - its Forms and Functions' 44 *Southern Cal. L. Rev.* 305 (1971).

[33] K. Mackie, 'Mediation Futures' Rethinking Disputes: The Mediation Alternative in J. MacFarlane (ed.) 371, at 372 (Cavendish, 1997).

[34] H. Genn, *Judging Civil Justice* 117 (CUP, 2010) stating that '[t]he outcome of mediation is not about *just* settlement, it is *just about settlement.*'

justice system operates and promises 'justice through law [whereas in mediation] justice is derived, not through the operation of law, but through autonomy and self-determination.'[35] Court mediation is sometimes regarded as problematic and analogous to plea bargaining on the basis that 'consent is often coerced; the bargain may be struck by someone without authority; the absence of a trial and judgment renders subsequent judicial involvement troublesome [and] … settlement is a capitulation to the conditions of mass society and should be neither encouraged nor praised.'[36] Same arguments have been forwarded by the members of the UK judiciary who have also warned that the voluntary nature of mediation should be protected.[37] Critical views on mediation have been forwarded by the judiciary that the court should not have jurisdiction to compel parties to mediation and even it has jurisdiction that jurisdiction would not be appropriate.[38] Similar arguments have been raised against arbitration, and inter alia mediation, in that private dispute resolution mechanisms due to their confidential nature do not enable the progress of law whereas 'open court proceedings enable people to watch, debate, develop, contest, and materialize the exercise of both public and private power'.[39]

The advantages of mediation has been put to practice in the enforcement of security interests. The cost associated with court litigation seems to be different among countries, since the court system and related infrastructures such as judges' knowledge about commercial transactions may be markedly different among countries. Efficient enforcement of secured creditor's rights is a key objective of modern secured transactions law texts.[40] Transnational texts recommend out-of-court or extrajudicial enforcement as a fundamental policy and a mechanism as part of the secured creditor's right of exercising its post-default rights on the assets.[41] Extrajudicial enforcement, which is also called as *self-help remedies*, may be defined as 'legally permissible conduct that individuals undertake absent the compulsion of law and without the assistance of a government official in efforts to prevent or remedy a civil wrong.'[42] While the use of arbitration in financial and banking law disputes is not uncommon,[43] mediation in disputes arising in the context of enforcement of security

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[35] J.M. Nolan-Haley, 'Court Mediation and the Search for Justice Through Law' 74 *Washington University Law Quarterly* 47, 49 (1996).

[36] *E.g.* O. Fiss, 'Against Settlement' 93 *Yale L. J.* 1073, 1075 (1984).

[37] *See* A. Hildebrand, 'The United Kingdom' in *EU Mediation Law and Practice* G. de Palo and M. B. Trevor (eds) at 380 (OUP, 2012) (*citing* Hon Mr Justice Ramsay, 'Experts warn against mandatory mediation at CIArb Mediation Symposium' (21 October 2011) Key note Speaker, CIArb News; and Rachel Rothwell, 'Neuberger warns against mediation and defends legal aid and Jackson' referring to Lord Neuberger MR, at the annual Bentham Lecture 2011 (4 March 2011) Law Society Gazette).

[38] *Halsey v Milton Keynes NHST* [2004] 4 All ER 920, per Lord Justice Dyson, paras 9 and 10 '…that compulsion of ADR would be regarded as an unacceptable constraint on the right of access to the court…"

[39] The Right Hon. The Lord Thomas of Cwmgiedd, Lord Chief Justice of England and Wales '*Developing commercial law through the courts: rebalancing the relationship between the courts and arbitration'* 9 March 2016, *The Bailii Lecture* 2016, available at https://www.judiciary.gov.uk/wp-content/uploads/2016/03/lcj-speech-bailli-lecture-20160309.pdf (accessed January 2017) (*citing* J. Resnik, 'Courts: In and Out of Sight, Site and Cite' 53 *Vill. L. Rev.* 771, 804 (2008)).

[40] *See e.g.* UNCITRAL Legislative Guide on Secured Transactions (h), para. 56, p. 21.

[41] *See e.g.* UNCITRAL Legislative Guide on Secured Transactions (k), para. 71, p. 26, Recs. 1 and 142; UNCITRAL Model Law on Secured Transactions Guide to Enactment, para. 52, A/CN.9/WG.VI/WP.71/Add.5.

[42] D. I. Brandon *et. al.*, 'Self-Help: Extrajudicial Rights, Privileges and Remedies in Contemporary American Society', 37 *Vand. L. Rev.* 845, 850 (1984).

[43] *See e.g.* W.P. Park, 'Arbitration in Banking and Finance' 17 *Annual Review of Banking Law* 213 (1998); I. Hanefeld, 'Arbitration in Banking and Finance' 9 *NYU J. Law & Business* 917 (2013); S. Kroll, 'Arbitration and Insolvency - Selected Conflict of Law Problems' *in Conflict of Laws in International Arbitration,* F. Ferrari and S. Kroll (eds) 211 (Sellier, 2010).

interests has been widely ignored in the literature.[44] This is understandable because the use of mediation in secured transactions disputes is a rare occasion outside certain jurisdictions where there is an established mediation practice and culture.[45] The non-binding nature of mediation may also be regarded as an element of prolonging the process of enforcement.

In a typical commercial relationship which involves taking security over the assets of the grantor, disputes may occur during pre-or post-default periods. Disputes in secured transactions, where mediation may be utilised during pre-default process where the disputes are contractual in nature, may often arise in relation to the terms of the loan agreement, whether a default has occurred, whether the security has been made effective against the third parties, whether security interest as drafted in the agreement covers after-acquired property, enforcement related issues and the priority disputes of secured creditors over the same collateral.

A typical use of mediation during the post-default period occurs when a grantor who has given a security interest over her assets to a secured creditor, defaults in the payments and refuses to give up the asset. The secured creditor, in the absence of a dispute resolution clause in the loan agreement, may have to submit the dispute to the local courts. Local courts may be inefficient or biased or their workload has to be reduced. The secured creditor has a number of concerns including preservation of the collateral and its value during foreclosure process, obtaining or conveying good title to the collateral free of defects, identifying any encumbrances on the collateral that may impair title, enforcement of its lien through liquidation of the collateral, recovery from the borrower any deficiency in the proceeds of the liquidation.[46] In the same token, the borrower has certain concerns which include protection from losing the title, receiving sufficient notice of foreclosure, contesting the existence of a default, having the opportunity to cure the default.[47] Third parties' concerns include receiving adequate notice of the foreclosure, ability to verify the validity of foreclosing secured creditor's claim, preservation of its rights to recover deficiencies from the borrower.[48] Therefore, before submitting the dispute to courts adding a layer of dispute resolution mechanism to reach an agreeable, speedy and amicable solution between the parties may be helpful in reducing the cost of credit and creating legal certainty. This is particularly important when the grantor and the secured creditor have a long standing business relationship. From another perspective the use of mediation in the enforcement of security interests is a positive approach, as it provides access to justice and ability to appreciate the consequences of enforcement of security interests to those grantors in post-default process. It can be argued that mediation is a useful method which may help resolve SMEs' access to finance. However, it is also important to note that the grantor may have third party creditors who have rights on the grantor's assets. A confidential and non-transparent[49] dispute resolution mechanism may, thus, compromise third party rights. Also, mediation may be regarded as a procedure to delay the process. A mediator may not necessarily have a jurisdiction over third parties located in different jurisdictions. It may not have the relevant authority to resolve priority disputes among third party creditors. Therefore, these concerns

[44] *See e.g.* C.M.L. Rodriguez, 'Enforcing Contracts and Resolving Disputes in Contract Farming: How ADR can address the specificities of agricultural production contracts' 20 *Uniform L. Rev.* 180 (2015) (which examines the use of mediation in contract farming).

[45] For the evolution of mediation in the USA *see e.g.* K.K. Kovach, 'The Evolution of Mediation in the United States: Issues Ripe for Regulation May Shape the Future of Practice' in *Global Trends in Mediation*, N. Alexander (ed.) 389 (Kluwer, 2006).

[46] D. L. Rome and D.M.S. Shaiken, 'Arbitration Carve-out Clauses in Commercial and Consumer Secured Loan Transactions' Dispute Resolution Journal 1, 3 (August/October, 2006).

[47] *Ibid.*

[48] *Ibid.*

[49] For criticism with regards to Transparency *see below.*

should also be addressed in the creation of a dispute resolution system related to post-default rights by including third parties in the process. For the purposes of this article we will only focus on the use of mediation as an extrajudicial enforcement mechanism in the exercise of post-default rights. The rationale for this is during the exercise of these rights, certain safeguards for third party rights must be observed.

The ability of third party creditors to join the mediation process against the grantor and the enforceability of the settlement agreement against third party creditors of the grantor are significant points within the scope of this article. We shall now turn to these tension points in the context of secured transactions and mediation.

3. The use and impact of mediation in disputes related to the enforcement of security interests

Cost of litigation and lengthy delays in civil litigation have led to public dissatisfaction and contributed to the rise of mediation from 1980s as an adjudicative model in both domestic and cross-border disputes.[50] This is also the case in emerging economies where the court system cannot effectively handle the weight and speed of commercial disputes and offer specialised solutions. These concerns are coupled with the potential bias of courts. This is explained by Macduff as follows:

> "the complexities of jurisdictional choice, the cost of litigation relative to the value of the claim, and the problems of cross-border enforcement have meant that something other than the conventional court has to serve the purpose, involving the design of dispute resolution mechanisms that are freed from the physical structures of the court yet nevertheless grounded on the normative and enforcement structures of domestic legal systems."[51]

Various comparative studies of the World Bank have also provided evidence that alternative dispute resolution systems can save cost and time as well as improve the effectiveness of courts, business environment and trust in the legal system.[52] Similar findings are supported by the UNCITRAL which noted that use of mediation can 'reduce the workload of courts and help parties achieve a balanced solution that both protects their rights and the rights of third parties, and makes low-cost credit available.'[53] When the above are put into context, it can be argued that the flexible, fast and customer oriented nature of mediation has led to its use in financial, banking and secured transactions law disputes. Particularly its boundaries have been extended to the resolution of disputes related to post-default rights (enforcement of security interests). This is not surprising as mediation works for 'transforming individual cases, and … as an expression of potential for social

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[50] *See generally* 'Access to Justice: Final Report to the Lord Chancellor on the Civil Justice System in England and Wales' (1996) Section II (The Woolf Report); 'Review of Civil Litigation Costs: Final Report' (December 2009) available at https://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/Reports/jackson-final-report-140110.pdf (accessed March 2017) especially chapter 36. For more discussion *see* J. Macfarlane 'The Mediation Alternative' *Rethinking Disputes: The Mediation Alternative* in J. Macfarlane (ed.), 1, at 4 *et seq* (Cavendish, 1997).

[51] I. Macduff, 'Leaving Disputants to Their Own Devices: the Vulnerable Potential of Mobile Access to Justice' *Essays on Mediation: Dealing with Disputes in the 21st Century, Global Trends in Dispute Resolution*, v. 6, I. Macduff (ed.) 219, at 221 (Kluwer Law International, 2016).

[52] *See e.g.* A. Alvarez de la Campa, 'The Private Sector Approach to Commercial ADR: Commercial ADR Mechanisms in Colombia' *Investment Climate Department*, World Bank Group; I. Love, 'Settling Out of Court' *Viewpoint* number 329, The World Bank Group (October 2011) http://www.worldbank.org/fpd/publicpolicyjournal (accessed May 2017).

[53] A/CN.9/913, para. 62.

transformation.'[54] As an example, in the USA, the use of mediation in secured transactions, banking and securities disputes has grown in 2016.[55] Nevertheless, legal systems' approach to the use of ADR in enforcement related disputes may differ. The nature of mediation as a non-binding method of resolution of disputes, however, may prevent it from being used or accepted as an alternative to court proceedings in the enforcement of a security right.

Several transnational secured transactions law texts have also recommended or adopted the method of using extrajudicial enforcement mechanisms (such as ADR and arbitration) even during exercising post-default rights.[56] The UNCITRAL Legislative Guide on Secured Transactions under Recommendations 142[57] and 229[58] makes reference to the fact that disputes with regard to post-default rights of the parties could be resolved by way of judicial or arbitral proceedings. The UNCITRAL Model Law on Secured Transactions, too, provides a regulatory approach in relation to post-default rights under article 3 (party autonomy) and article 73 (methods of exercising post-default rights).[59] Parties have been granted the freedom to agree on the enforcement procedure.[60] Efficient enforcement of secured creditor's rights is a key objective of the UNCITRAL Legislative Guide[61] and the UNCITRAL Model Law. Out-of-court or extra judicial enforcement is a fundamental policy under the UNCITRAL Legislative Guide[62] and the UNCITRAL Model Law.[63] The UNCITRAL Model Law on Secured Transactions article 3(3) suggests that alternative dispute resolution methods may be used between the grantor and the secured creditor. However, this provision does not clarify whether or not mediation may be used in enforcement related disputes and whether the use of alternative dispute resolution mechanisms has an effect on third party rights. This is left to the Guide to Enactment for this paragraph which reads as follows:

> "Paragraph 3 makes clear that, if other law allows the grantor and the secured creditor to agree to resolve any dispute that may arise between them from their security agreement or a security right created by that agreement by arbitration, mediation, conciliation and online dispute resolution, nothing in the Model Law affects any agreement to use such alternate dispute resolution mechanisms. Paragraph 3 is based on the assumption that, the use of alternative dispute resolution mechanisms to

[54] Mackie, *supra* note 33, at 372.

[55] Financial Industry Regulatory Authority (FINRA) publishes the statistics available at http://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics#mediationstats (accessed May 2017).

[56] Whether the settlement agreement between the secured creditor and the grantor is effective as against third parties.

[57] Rec. 142 on *Judicial and Extrajudicial methods of exercising post-default rights* reads as follows: "The law should provide that, after default, the secured creditor may exercise its rights provided in recommendation 141 either by applying to a court or other authority, or without application to a court or other authority. Extrajudicial exercise of the secured creditor's rights is subject to the general standard of conduct provided in recommendation 131 and the requirements provided in recommendations 147-155 with respect to extrajudicial obtaining of possession and disposition of an encumbered asset."

[58] Rec. 229 on *Inapplicability of the law to actions commenced before the effective date* reads as follows: "The law should provide that it does not apply to a matter that is the subject of litigation or alternative binding dispute resolution proceedings that were commenced before the effective date. If enforcement of a security right has commenced before the effective date, the enforcement may continue under the law in force before the effective date ("prior law")."

[59] A/CN.9/WG.VI/WP.73, paras 71-74; A/CN.9/WG.VI/WP.71/Add.5, paras 52-56. Article 3(3) reads as follows: "Nothing in this Law affects any agreement to use alternative dispute resolution, including arbitration, mediation, conciliation and online dispute resolution."

[60] UNCITRAL Legislative Guide on Secured Transactions Law, paras 16-17, pp. 279 and paras 29-33, pp. 283-284.

[61] UNCITRAL Legislative Guide on Secured Transactions, (h), para. 56, p. 21.

[62] UNCITRAL Legislative Guide on Secured Transactions, (k), para. 71, p. 26; Recommendations 1 and 142.

[63] UNCITRAL Model Law, article 73.

> resolve disputes arising between the parties from their security agreement or the security right created by that agreement is important, in particular for developing countries, to attract investment. To the extent it is inefficient, judicial enforcement is likely to have a negative impact on the availability and the cost of credit. It should be noted that paragraph 3 is intended to recognize alternative dispute resolution mechanisms, without interfering with the way in which the various legal systems deal with arbitrability of disputes arising under a security agreement or a security right, the protection of rights of third parties or access to justice."[64]

The Organisation of American States Model Inter-American Law on Secured Transactions enables the use of arbitration and private settlement[65] in the post-default process and leaves the detailed regulation to enacting states.[66] It is clear that the OAS approach and the UNCITRAL Model Law's approach here differs, in the sense that the Model Law article 3(3) does not positively suggest the use of arbitration or ADR and leaves it to the local/national law. On the other hand, the OAS Inter-American Model Law article 68 positively enables parties the use of arbitration but not mediation. The World Bank Secured Transactions Systems and Collateral Registries Toolkit also makes reference to the use of alternative dispute resolution mechanisms in extrajudicial recovery of possession.[67] It is clear that international organisations' preference in the enforcement of security interests is to bypass somewhat burdensome, costly and perhaps, biased national court systems. Delays, inefficiencies and costs associated with lengthy hearings have adverse effect on the availability and the cost of credit.[68] The UNCITRAL Secretariat's note on this matter provides some clarity as follows:

> "…enforcement of security rights securing very small loans, a simplified out-of-court procedure may be needed with some protection for the debtor built in. Moreover, it may be necessary to move towards a "small claims" court model to facilitate enforcement by means of pre-designed templates with limited access to appeal, and/or to consider the use of Alternative Dispute Resolution (whether physical or online) as alternatives to court proceedings." [69]

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[64] UNCITRAL Model Law on Secured Transactions Guide to Enactment, page 20, para. 74 A/CN.9/WG.VI/WP.73.

[65] Article 4(V) reads as follows: "The secured obligation, in addition to the principal debt may consist in: … V. Damages caused by the breach of the security contract as determined by a court, arbitration award or private settlement; …"

[66] Article 68 reads as follows: "Any controversy arising out of the interpretation and fulfilment of a security interest may be submitted to arbitration by the parties, acting by mutual agreement and according to the legislation applicable in this State." For the text of the Organisation of American States Model Inter-American Law on Secured Transactions *see* http://www.oas.org/en/sla/dil/docs/secured_transactions_BOOK_Model_Law.pdf (accessed January 2017). For an analysis of the OAS Model Inter-American Law on Secured Transactions *see* B. Kozolchyk and J. Wilson, 'The Organization of American States' Model Inter-American Law on Secured Transactions' 7 *Uniform L. Rev.* 69 (2002).

[67] http://www.ifc.org/wps/wcm/connect/c5be2a0049586021a20ab719583b6d16/SecuredTransactionsSystems.pdf?MOD=AJPERES (accessed May 2017) p. 52-54.

[68] A/CN.9/913, para. 61; for the use of mediation in Latin America *see also* H. Falcao and F.J. Sanchez, 'Mediation - An Emerging ADR Mechanism in Latin America' in *International Arbitration in Latin America*, N. Blackaby, D. Lindsey, A. Spinillo (eds), 415-438, (Kluwer, 2002).

[69] A/CN.9/913, para. 40.

During the deliberations of the UNCITRAL Model Law on Secured Transactions, the Working Group VI considered the use of ADR in the exercising post-default rights.[70] The Report of Working Group VI on the work of its 30th Session noted that "while at its twenty-ninth session … there was general agreement as to the value of ADR, it was agreed that, in view of the complexity of the matter and the need to coordinate with Working Group II […] and to discuss the matter on the basis of a detailed proposal, no reference to ADR should be made in … [article 73] or other part of the draft Model Law."[71] This is a correct approach as there are differences between various mechanisms and there is no clarity as to what "other authority" means.

Extra-judicial or out-of-court enforcement has different methods. The most prominent one is the seizure by the secured creditor where a proof of security agreement, notice of default to the grantor or any person in possession and default by the grantor are sufficient to trigger the process.[72] The asset can be seized from the grantor without the assistance of execution office. In order for this to be possible post- or pre-default consent of the grantor is necessary. It is suggested for the purposes of ease pre-default consent that the grantor agrees to the extra-judicial enforcement and mediation must be obtained when security agreement is concluded. In this context, the use of mediation adds an additional layer of dispute resolution mechanism before the parties submit their disputes to a court. But this type of additional layer which enables parties to reach a speedy and amicable solution is present in developed legal/regulatory and institutional frameworks. That is why the UNCITRAL Model Law article 3(3) supports the idea of party autonomy and leaves it to the parties' agreement whether or not to submit their disputes by agreement to an alternative dispute resolution mechanism. Article 73 of the Model Law, which is based on Recommendation 142 of the UNCITRAL Legislative Guide, provides clarity to these types of arrangements. According to article 73 the secured creditor may exercise its post-default rights by either applying to a court or other authority or without such application. The Working Group VI felt that it would not be useful to refer to an arbitral tribunal in the context of *other authority* and that reference to it in article 3(3) was sufficient.[73] The clarification of 'other authority' was left to the Guide to Enactment. Thus, 'other authority' will be specified by the enacting State and it can be a chamber of commerce, arbitral tribunal or notary public. The Guide to Enactment documents related to article 73 provide clear reasons why a secured creditor may choose to exercise post-default rights as mapped out in the Model Law. According to the Guide to Enactment

> "judicial or similar proceedings may not be sufficiently efficient, the secured creditor may wish to avoid having its self-help actions subsequently challenged, the secured creditor may anticipate that it will have to apply to a court or other authority anyway to recover an anticipated deficiency or may fear and wish to avoid a breach of public order."[74]

Therefore, the use of mediation in enforcement related disputes may have positive impact on certain issues. Firstly, cost of credit may be lowered when confidence is provided to the secured creditor that there are efficient enforcement mechanisms. These include the right of secured creditor to take the asset without the assistance of courts of execution office. It is possible that the grantor may relocate, hide or damage the assets to reduce its value. Therefore, when parties agree to mediate their disputes related to enforcement of security

[70] A/CN.9/836, paras 48-50.
[71] A/CN.9/899, para. 117; A/CN.9/871, para. 85.
[72] UNCITRAL Model Law article 77.
[73] A/CN.9/899, para. 119.
[74] A/CN.9/914/Add.5, para. 58; A/CN.9/WG.VI/WP.71/Add.5, para. 52; Secured Transactions Legislative Guide, chapter VIII, paras. 32 and 33.

rights there must be certain measures to prevent the grantor from reducing the value of the assets. Second, courts may be biased or not have any specialist knowledge on the matter. Third, litigation may be expensive and take years during which the value of the assets may diminish. Fourth, speedy resolution of enforcement related disputes may have the benefit of protecting the assets and their values.

However, to the extent mediation and secured transactions are concerned, two questions are still crucial. The first of these poses the question as to whether third parties (*i.e.* other secured creditors of the grantor) may join in the ongoing mediation process. The second of these poses the question of impact of settlement agreement on third parties who are not part of the mediation process (*i.e.* whether the settlement agreement is enforceable against those third parties).

3.1 Joinder or participation of third parties in the mediation of enforcement of security interests

It is possible to include additional parties in alternative dispute resolution process and this is a common provision in many arbitration rules.[75] The main rule is that until the confirmation or appointment of any arbitrator third parties can join, unless all parties, otherwise, agree.[76] Multiple parties and complexity of subject matter of disputes are likely factors that make mediation particularly difficult to manage. Disputes involving multiple parties with independent interests and multiple issues pose a number of problems. These include logistical issues where the mediator has to handle each party's claim and experts; allot sufficient time to each participant to provide procedural fairness; design and apply individual procedures for each party while focusing on the ultimate joint outcome; the possibility of relationships between the parties and claims; proper sequencing and prioritising of claims and negotiations; and the appreciation of individual positional debates, interests and claims.[77] Multi-party mediation with multiple claims and issues may occur in disputes involving secured transactions, manufacturing, insurance, wrongful death, medical malpractice and property ownership.[78] The key factor in these types of disputes is need to separate the claims and settlements of each creditor/plaintiff. This requires a number of mediator teams with certain expertise and separate hearings. These ensure that third party rights are simultaneously protected.

Typical disputes that may arise in the context of mediation of enforcement of security interests relate to priority between foreclosing creditor and other creditors and the grantor (Article 76 of the UNCITRAL Model Law). This may require multi-party mediation. Mediation has to commence before the foreclosure. The mediator has to invite all interested parties for a mediation session which may be conducted through private sessions (*caucuses*). Similar to arbitration, including additional parties into the process of mediation increases the chances of achieving a mutually acceptable settlement. In fact, some dispute resolution institutions clearly indicate that additional parties may be included in the mediation process and identifying these third parties who must participate in the mediation process is the

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[75] *E.g.* ICC Rules of Arbitration article 7 (if an existing party files a *request for joinder*); ICDR International Arbitration Rules article 7; HKIAC Administered Arbitration Rules article 27; UNCITRAL Arbitration Rules article 17(5); SIAC Rules rule 24(1); LCIA article 22(1)(vii).

[76] Although the HKIAC Administered Arbitration Rules article 27(1) are expansive and allow the tribunal to decide after the creation of the tribunal as to whether joinder of additional parties should be allowed.

[77] L. M. Watson, Jr, 'Planning, Organizing, Formatting and Executing the Mediation of a Complex, Multi-party, Multi-issue Lawsuit' 9 *Am. J. Mediation* 111, at 112 (2016).

[78] R.A. Max, 'Multi-party Mediation', available at https://www.law.ufl.edu/_pdf/academics/centers/cgr/7th_conference/Multiparty_Mediation.pdf at 2-4 (accessed September 2017).

'exclusive responsibility' of the parties (*i.e.* the grantor and the secured creditor).[79] Other institutions provide a similar approach to the invitation of third parties. According to International Commercial Dispute Resolution (ICDR) Centre's International Mediation Rules suggest the ICDR to invite other party or parties to mediation.[80] The mediation agreement can either be made ex ante (made by parties who know the values of mediation) or ex post (to promote settlement and to reduce dispute resolution costs).[81] In the context of enforcement disputes, it is possible to conclude mediation agreements ex ante or ex post. In both cases parties will have benefit from it. In order to include additional parties (the third party creditors of the grantor) in the mediation of enforcement of security interests, an information mechanism is necessary. This is so for the simple reasons that they need to be aware of the higher ranking secured creditor's commencement of enforcement. The grantor and the enforcing secured creditor should consent to the addition of other third party creditors to the mediation process.

In order to protect the confidential nature of parties' interests and information that they may disclose, the mediator may prefer meet with the parties in private sessions. The significant question here is that how these third party creditors are going to be found and notified of the commencement of the extrajudicial enforcement mechanism so that they can be protected from the enforcement of security interests. The UNCITRAL Model Law provides a number of clear answers to these concerns where third-party rights in an encumbered asset may be protected from enforcement. Under article 74, option B, any third party is allowed to seek relief for non-compliance by the enforcing secured creditor with the provisions of the chapter on enforcement. This article is based on UNCITRAL Legislative Guide on Secured Transactions recommendation 137. It deals with the availability of relief from a court or other specified authority to a grantor, debtor or a person with rights on the encumbered asset whose rights are affected by the non-compliance of the secured creditor with the obligations under the enforcement chapter of the Model Law. The article also requires the enacting State to specify the court or other authority where relief may be sought. Under article 75(1), which is based on recommendation 140 of the UNCITRAL Legislative Guide on Secured Transactions, any third party is permitted to terminate enforcement. The grantor, any other person with a right in the encumbered asset or the debtor is entitled to terminate the enforcement process. This is performed either by paying or otherwise performing the secured obligation in full, including the reasonable cost of enforcement. The party exercising the termination right may request the assistance of a court or other authority as specified in article 74 to determine whether the secured creditor's assertion that the cost of enforcement is reasonable.[82] Article 76(1) entitles a higher-ranking secured creditor with the right to take over enforcement. This is possible notwithstanding the commencement of enforcement procedure by another creditor (a lower ranking secured creditor or a judgment creditor). This is article is based on recommendation 145 of the UNCITRAL Legislative Guide on Secured Transactions. The protection of the right of the higher ranking secured

[79] For a joinder of parties in mediation *See e.g.* ADR Center Mediation Rules article 12(d) http://www.adrcenter.it/en/mediazione/regolamento-mediazione/ (accessed March 2017).

[80] ICDR International Mediation Rules article 2(3) https://www.icdr.org/icdr/ShowProperty?nodeId=/UCM/ADRSTAGE2020868&revision=latestreleased (accessed March 2017). "Where there is no pre-existing stipulation or contract by which the parties have provided for mediation of existing or future disputes under the auspices of the ICDR, a party may request the ICDR to invite another party to participate in "mediation by voluntary submission." Upon receipt of such a request, the ICDR will contact the other party or parties involved in the dispute and attempt to obtain a submission to mediation."

[81] For an economic analysis of ADR *see* S. Shavell, 'Alternative Dispute Resolution: An Economic Analysis' 24 *J. Legal Stud.* 1 (1995).

[82] UNCITRAL Draft Guide to Enactment, A/CN.9/914/Add.5, para. 66.

creditor is justified as the enforcement may have adverse impact on its rights. This is explained in the draft Guide to Enactment as follows:

> "… if a subordinate creditor exercises its right to dispose of the encumbered asset judicially, the security right of the higher-ranking secured creditor will usually be extinguished … and replaced by a right to priority of payment out of the proceeds realized by the subordinate creditor; it therefore has an interest in controlling the enforcement process. If the subordinate creditor instead exercises its disposition right extrajudicially, the security right of the higher-ranking creditor will follow the asset into the hands of the transferee to whom the enforcing creditor disposes of the asset …, thereby potentially forcing the higher ranking secured creditor to commence enforcement proceedings against that transferee."[83]

Article 77(2) the enforcing secured creditor is required to give notice of default to any third party in possession of an encumbered asset and any such third party is given the right to prevent the out-of-court re-possession of the encumbered asset by the secured creditor. This is particularly an important section because it provides a clear protection to lower ranking creditors. The significant deficiency in the provision is the question as to how this notice is going to be given and received by the other creditors. The OAS Model Law under articles 54 and 55 provide a practical solution of notification of third party creditors. These third parties are informed via an enforcement registration notice in accordance with the procedure set out under article 54. However, there is no clarity as to whether third parties who have not publicised their security interest should be actively checking this enforcement registration notice system. Under the UNCITRAL Model Law or in the future work of the UNCITRAL, when the secured creditor is exercising her post-default rights, it might be useful to follow a hybrid method of notifying third parties of the commencement of enforcement. It is submitted that this should involve a two tier system where the burden of informing third party creditors lies both on the secured creditor and the grantor. The secured creditor's responsibility should be akin to the responsibility and the method indicated under the system adopted by the OAS Model Law article 54. This enforcement registration notice should also act as an invitation to mediation if a dispute arises in the enforcement process. The grantor's responsibility should be to inform the mediator of the unsecured creditors so that they can be invited to join mediation, too. Article 78(4) requires the enforcing secured creditor to give notice to third-party creditors, grantor, the debtor and any person with a right in the encumbered asset of its intention to dispose of an encumbered asset out of court. The notice indicates the rights, any other secured creditor that registered a notice in the Registry and any other secured creditor in possession of the asset. Other creditors with rights on the encumbered asset must notify in advance the secured creditor of their rights or secured creditors that registered a notice in the Registry. This is necessary in order to be notified of the enforcement by the secured creditor so that other creditors can exercise their rights. The time for this notice by the secured creditor to the other creditors is decided by the enacting State.[84] Under article 79(2), which is based on recommendations 152-155 of the UNCITRAL Legislative Guide on Secured Transactions, the secured creditor is required to follow certain rules in distributing the proceeds of an out-of-court disposition of an encumbered asset. The enforcing secured creditor is entitled to apply the proceeds in satisfaction of the obligation secured by its security right after first reimbursing itself for its reasonable costs of enforcement. Any surplus is then paid to the subordinate competing claimants that have notified the enforcing secured creditor. The rest of the proceeds are paid to the grantor.[85] Under article 80(2), which

[83] UNCITRAL Draft Guide to Enactment, A/CN.9/914/Add.5, para. 68.
[84] UNCITRAL Draft Guide to Enactment, A/CN.9/914/Add.5, para. 78.
[85] UNCITRAL Draft Guide to Enactment, A/CN.9/914/Add.5, para. 82.

is based on recommendations 156-159 of the UNCITRAL Legislative Guide on Secured Transactions, the enforcing secured creditor is required to send the proposal for the acquisition of an encumbered asset to third-party creditors.[86] For other creditors who have notified of their rights to the secured creditors, the enforcing secured creditors shall provide a short notice as specified by the enacting State to enforce their rights.

The system suggested under the Colombian law provides extrajudicial enforcement in the form of official relief administered by the Superintendence of Companies, rather than the courts. This agency handles both liquidations and reorganizations.[87] This system proposes three tiers. At the top the grantor is expect to return the asset to the secured creditor in case of default. If the grantor refuses, under the second tier the parties follow ADR route. If this is unsuccessful, parties in the third tier follow the court route. Article 78 of the Colombian secured transactions law goes further than international texts and provides that: "If the parties so decide, any controversy that arises with respect to the creation, interpretation, perfection, performance, enforcement and liquidation of a security interest can be subject to conciliation, arbitration, or any other alternative dispute resolution mechanism, according to national legislation and applicable international treaties and conventions."[88] While this is a useful method, it is argued that time is of essence when assets need to be protected. Thus, parties should be free to commence arbitration or litigation should mediation or dispute resolution mechanism do not realistically seem to provide a solution. Parties to a secured transaction may have a multi-tiered dispute resolution clause and this should to be respected. Parties have to agree on this enforcement procedure when concluding their secured transaction.

3.2 Criticism of mediation in disputes related to enforcement of security interests

It can be argued that the use of mediation in enforcement related disputes may have unintended effects on third parties. These are called the '*externalities*'. Trebilcock argues the following in relation to externalities.

> 'Even if both parties to a particular exchange benefit from it, the exchange may entail the imposition of costs on non-consenting third parties. From a welfare perspective Pareto criterion will not be met if an exchange has made some better off while other worse off. In terms of Kaldor-Hicks efficiency the welfare implications of the exchange would entail balancing the costs to third parties against the gains to the immediate parties to the exchange."[89]

The State has certain duties. These can be extended to the relationships between the grantor and the secured creditor. These are part of the *system of natural liberty* that Adam Smith suggests in the Wealth of Nations. The duty of "establishing an exact administration of justice" is related to this point.[90] Parties with long standing commercial relationships may suffer from ambiguities. In order to reduce these ambiguities and to avoid being subject to local courts, parties may agree to subject their disputes to arbitration or mediation. But in each case, 'the court of last resort is provided by the governmental judicial system.'[91] Furthermore, the agreement of two parties (the grantor and the secured creditor) to submit

[86] UNCITRAL Draft Guide to Enactment, A/CN.9/914/Add.5, para. 85, "…secured creditor must send the proposal to the same categories of persons to whom advance notice of an intended extrajudicial disposition must be sent under article 78, paragraph 4."

[87] I would like to thank Marek Dubovec for providing this information (in file with the author).

[88] A/CN.9/913, para. 69.

[89] M. Trebilcock, *Limits of Freedom of* Contract 58 (Harvard University Press, 1992).

[90] M. Friedman, *Free to Choose*, 50 (Penguin, 1981) (citing Adam Smith's *Wealth of Nations* Book V chapter 1).

[91] Friedman, *above* note 90, at 50.

their disputes to mediation has effects on third parties (people who are not parties to a particular contract or relationship or exchange). The commercial relationship may unintentionally or sometimes intentionally imposes costs on third parties. These are called the *external costs*.[92] Examples of these include a third party's search whether the first secured creditor has commenced enforcement and whether third parties have means to be informed about the enforcement to be able to secure their assets. Secured creditors are not concerned about the fact that their agreement affects third parties' rights. Because their first concern is the effective enforcement of security rights between them and the grantor. The inclusion of a mediation clause where third party's rights are concerned is in the interest of the higher ranking secured creditor. Another concern is the interplay between and co-existence of a non-adjudicative method (mediation) and an adjudicative method (court) where the judge has to approve the ruling in the mediation.

The admissibility of evidence in the subsequent proceedings is also a disadvantage of mediation. This matter goes to the heart of the nature of mediation where the expectation is that parties as well as the mediator should retain confidential information obtained during the mediation hearings and should not disclose in the subsequent proceedings if the mediation fails to produce a settlement agreement. This could lead to loss of valuable time if the assets need to be repossessed by the secured creditor and the grantor has the interest to prolong the process. Prolonging the process is also an issue under mediation. Unsettled mediation may increase the cost of enforcement and cause further delays. Bearing in mind that enforcement process needs to be fast, use of mediation has to be carefully thought of. A well drafted mediation agreement will be a necessity.[93] Another significant disadvantage of mediation is that it lacks *transparency*. Unlike most arbitral awards, particularly investment arbitration awards, or court decisions, both mediation hearings and settlement agreements are confidential and the process is not transparent. Transparency in dispute resolution is also one of the main areas identified by the United Nations, particularly, in relation to microfinance.[94] UNCITRAL Rules on Transparency in Treaty-based Investor State Arbitration relate to investment arbitration which affects public funds and thus require transparency in relation to investment arbitration awards.[95] Three categories of transparency have been identified: *Organisational transparency*, which requires arbitral institutions to be more proactive in becoming transparent in their management and decision making; *legal transparency*, which requires publicity of arbitral decisions; and *transparency of proceedings*, which requires public proceedings and hearings.[96] While the above transparency categories are related to arbitration, especially legal transparency and transparency are of particular relevance to mediation. Disputes or contracts affecting third party rights by nature require transparency

[92] R. Coase, 'The Problem of Social Cost', 3 *Journal of Law & Economics*, 1-44 (1960); R. Coase, 'The Nature of the Firm' 4 Economica 386-405 (1937). Coase's theorem provides that when transaction costs are zero, institutions do not matter, parties to a transaction will bargain to an efficient result. However, transaction costs are almost never zero and are often yield substantial results.

[93] In the context of Bankruptcy Mediation *see e.g.* R. Kulms, 'Mediation in the USA: Alternative Dispute Resolution between Legalism and Self-Determination' in *Mediation – Principles and Regulation in Comparative Perspective*, K. Hopt and F. Steffek (eds.), 1245, 1299 *et seq* (Oxford, 2013).

[94] Report of the United Nations Commission on International Trade Law 45th session (2012) A/67/17, para. 124 "… (c) provision for fair, rapid, transparent and inexpensive processes for the resolution of disputes arising from microfinance transactions; and (d) facilitating the use of, and ensuring transparency in, secured lending to microenterprises and small and medium-sized enterprises."

[95] *See also* UNCITRAL Rules on Transparency in Treaty-based Investor State Arbitration http://www.uncitral.org/pdf/english/texts/arbitration/rules-on-transparency/Rules-on-Transparency-E.pdf (accessed January 2017).

[96] http://kluwerarbitrationblog.com/2017/03/04/how-much-more-transparency-does-commercial-arbitration-really-need/ (accessed May 2017).

due to public policy concerns. Thus, both the hearings and settlement agreements fail to fulfil transparency standards.

Obviously, the main question would be how far transparency would affect the negotiation of parties in the settlement process. Transparency serves a number of values in dispute resolution to the extent it is related to small businesses and micro finance. These are human rights; access to justice; fairness of dispute resolution process; effectiveness, credibility and legitimacy of dispute settlement mechanism, and assessment and accuracy of dispute resolution on small businesses.[97] Transparency is said to reduce corruption and provides accuracy in the implementation of decisions. Therefore, looking from the small and micro businesses lens, it is important to ensure transparency in the way disputes are resolved and in particular, to minimise the adverse consequences of lack of transparency in dispute resolution mechanisms on third parties. While mediation is an established method in economically advanced jurisdictions, economically less advanced jurisdictions do not have access to effective justice system. Non-transparent nature may also provide certain issues. One of these is that mediator who wishes the parties to resolve the matter may take a hard-line position. While parties may at any time leave the mediation process, this may not always possible and a possible compulsory system may compel the mediator to direct parties to a solution. The idea that alternative dispute resolution system may help reduce corruption is also not a well-established one.[98] Confidential nature of mediation may work against the creation of a set of precedents in the relevant area. But also non-transparent nature may exacerbate corruption if in the first place there are no measures to battle against corruption in the host jurisdiction. Also corruption is related to legal and social culture of a country. Thus, copy and paste solutions from other jurisdictions to enforce security interests may not always provide useful solutions. Thus, introducing mediation, which lacks transparency, in a particularly very complex field such as secured transactions and utilise it in post-default rights could raise tensions.

3.3 Enforceability of the mediated settlement agreement

The enforceability of the settlement agreement between the secured creditor and the grantor may affect the rights of third parties. These third parties are the other creditors of the grantor. In this context, legal issues related to the settlement agreement can be stated as the validity and existence of the agreement, and its enforceability.[99] But particularly, the issue lies with the question of whether the settlement agreement is enforceable against third parties.

The settlement agreement is regarded as a contract. While mediation process is not binding,[100] the settlement agreement at the end of the process is binding on the parties to the mediation.[101] The settlement agreement is enforceable as contract and failure to adhere to the agreement may lead to breach of contract. The agreement may also be embodied in a court judgment. The elements of a settlement agreement may cover, among other things,

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[97] For more discussion on each of these values *see* D. Magraw, 'Transparency and Dispute Settlement for Micro-Entrepreneurship' available at http://www.uncitral.org/pdf/english/colloquia/microfinance-2013/17-01/UNCITRAL_17-01-13_Transparency_DS_25_Dan_Magraw.pdf (accessed May 2017).

[98] *See above* for the criticism against mediation.

[99] Kovach, above *note* 45, at 434-435. For more discussion *see below*

[100] Park argues in relation to non-binding nature of mediation and conciliation that "[d]ispute resolution possessing a moral force only will be more effective in a closely knit, ethnically homogeneous community with repeat dealings among community members, rather than among culturally diverse and mutually suspicious (or even hostile) commercial actors." Above *note* 43, at 217, fn. 10.

[101] UNCITRAL Model Law on International Commercial Conciliation 2002 article 14 provides that settlement agreement is binding and enforceable and leaves the method of enforcement to adopting State.

'incentives or security for compliance'.[102] Security for compliance is necessary for parties to adhere to the terms of the agreement. The agreement may contain dispute resolution clause in order to resolve any disputes related to interpretation, amendment or implementation of obligations arising under the settlement agreement.[103] This clause may direct parties to submit their disputes arising out of the settlement agreement to mediation again. The success of the settlement agreement (mediated agreement) depends on whether the terms of the agreement or the decision have been reached by the parties or imposed upon the parties.[104] In the former case, there is likelihood of a successful outcome where parties are pleased with the result of mediation. In the latter case, however, the imposed terms may lead to parties' non-compliance (based on changing minds, regretting the decision made or the belief that they have been coerced into a resolution which they would not have entered into in the first place) with the settlement agreement. In those case, the enforceability of the agreement may suffer. In order to enforce the agreement, parties may have to bring the settlement agreement before a court. But this may pose certain problems mainly related to the confidentiality characteristic of mediation. Information divulged during the mediation process may have to be revealed and the use of mediator's testimony as to the validity and existence of settlement agreement may cause breach of confidentiality. The validity of a settlement agreement is governed by the general rules of contract law. Kovach points out that "[d]efences that have been raised to challenge the enforceability of a mediated agreement include claims of fraud, duress, coercion and lack of authority. However, in order to determine whether such claims are valid and enforceable, courts must investigate what took place at the mediation and in some cases this involves delving into the specifics of the mediation. A central concern is that such an investigation directly conflicts with provisions of confidentiality."[105] Confidentiality is important in order to ensure parties' disclosures which leads to resolution of the dispute. But also whether the mediator is able to disclose this information varies.[106] With regards to whether the settlement agreement is binding on third parties, it is important to make sure that the settlement agreement expressly refers to all the parties, that the sum being paid in settlement of all claims and that claims against related third parties should not be excluded.[107]

Under the European Directive on Mediation, Member States have the responsibility to ensure that the written settlement agreement is enforceable upon the request of one or more parties to the mediation.[108] This type of enforceability may enable the settlement agreement

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[102] D. Golann, *Mediating Legal Disputes Effective Strategies for Lawyers and Mediators*, 340 (Little, Brown & Co, 1996). Incentives and security for compliance may include 'escrow funds, bonds, penalties, liquidated damages, insurance, or other performance guarantees … [or] the agreement may be presented for adoption as the formal judgement of a court.'

[103] *See also* Goldberg *et al.*, above *note* 14, at 113 ('The mediated agreement … may be a private agreement or incorporated into a consent judgment in pending litigation. There may be an enforcement clause that provides for monitoring by the mediator or another party and specifies what the parties will do if they believe the agreement has been violated….')

[104] Golann, *ibid*, at 32, where he points that "[i]n many disputes, there is a settlement range, made up of terms that each side would accept rather than bear the additional cost and risk of litigating to a conclusion. If a mediator's designated 'fair' outcome or 'last offer' falls into this settlement range, a party will feel strong pressure to accept it."

[105] Kovach, above *note* 45, at 436

[106] See A. Marriott, 'Blessed are the Peacemakers' in *Law of International Business and Dispute Settlement in the 21st Century Liber Amicorum Karl-Heinz Böckstiegel*, R. Briner, L.Y. Fortier, K.P. Berger, J. Bredow (eds), 521 (Carl Heymanns Verlag, 2001).

[107] *Gladman Commercial Properties v Fisher Hargreaves Proctor and Others* (2013) EWCA Civ 1466

[108] European Union Directive on Mediation article 6 (1) reads as follows:

> "1. Member States shall ensure that it is possible for the parties, or for one of them with the explicit consent of the others, to request that the content of a written agreement resulting from mediation be made enforceable. The content of such an agreement shall be made enforceable unless, in the case in

to be given a similar status as a court judgment. Parties, thus, do not have to subsequently submit their disputes to a court. Under article 6(1) of the Directive, enforceability of a settlement agreement may be refused if the content of that agreement is contrary to the law of the Member State where the request is made or the law of that Member State does not provide for its enforceability. In that case, it may still be possible to render a settlement agreement enforceable directly by utilising the enforcement procedures in the Member State where the enforcement is sought. This can be done either by authentication of the settlement agreement by a notary public or by submitting the settlement agreement to the court to render it enforceable as a judgment.[109]

3.4 Examples of national legislations which use mediation in enforcement related disputes

Out of court enforcement is used in more than 100 countries. Mediation is used in many jurisdictions as part of commercial dispute resolution. However, the use of mediation in enforcement related disputes is rare and used, mainly, in the enforcement of security interests in farming equipment.[110] This is regarded as a restriction on the enforcement power of secured creditors "to protect family and individual farmers who own low-value items."[111] The secured creditor is required to go through a number of procedures before initialising extra-judicial enforcement. These restrictions to extra-judicial enforcement include provision of special notices, grace periods available to the debtor to cure the default and the availability of mediation before foreclosure.[112] In the USA, for example, Minnesota Statutes §17.91 requires mediation between agricultural commodity producer and contractor; and §27.131 between a buyer and seller. Under the Minnesota version of the UCC §9-601(h)-(i) in order to enforce a security interest the secured creditor first needs to serve a mediation notice. [113] In Utah under

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> question, either the content of that agreement is contrary to the law of the Member State where the request is made or the law of that Member State does not provide for its enforceability. …"

Directive's Preamble paragraph 19 also states that

> " … Member States should therefore ensure that the parties to a written agreement resulting from mediation can have the content of their agreement made enforceable. It should only be possible for a Member State to refuse to make an agreement enforceable if the content is contrary to its law, including its private international law, or if its law does not provide for the enforceability of the content of the specific agreement. This could be the case if the obligation specified in the agreement was by its nature unenforceable."

[109] This latter method is called the *homologation.* Following this enforcement is possible through the European Enforcement Order. For further details of direct enforcement of the settlement agreement *see* P. Billiet and E. Kurlanda, 'An Introduction to the Directive on Certain Aspects of Mediation in Civil and Commercial Matters' *in The New EU Directive on Mediation First Insights,* Association for International Arbitration (ed.), 9, at 18 (Maklu, 2008).

[110] For the use of ADR in contract farming *see* Rodriquez, above *note* 44.

[111] http://www.unidroit.org/english/documents/2015/study72k/sg03/s-72k-sg03-02-e.pdf (accessed May 2017), at 38, para. 217.

[112] Ibid, at 38, para. 217.

[113] Farmer-Lender Mediation Act 1987 and Programme https://www.extension.umn.edu/agriculture/farmer-lender-mediation/ (accessed May 2017). *Production Credit Association v Spring Water Dairy Farm Inc.* Minn SC 407 N.W. 2d 88 (1987); *E.g.* Minnesota Statutes Chapter 336 UCC §9-601(h)-(i). Sub-paragraph (h) reads as follows: "(h) *Security interest in collateral that is agricultural property; enforcement.* A person may not begin to enforce a security interest in collateral that is agricultural property subject to sections 583.20 to 583.32 that has secured a debt of more than $5,000 unless: a mediation notice under subsection (i) is served on the debtor after a condition of default has occurred in the security agreement and a copy served on the director of the agricultural extension service; and the debtor and creditor have completed mediation under sections 583.20 to 583.32; or as otherwise allowed under sections 583.20 to 583.32."

Sub-paragraph (i) provides a sample mediation notice. "*Mediation notice*. A mediation notice under subsection (h) must contain the following notice with the blanks properly filled in…" (*text of the mediation notice omitted*).

the Agricultural Credits Act 1987 mediation of farms debts is encouraged and this is a voluntary mediation programme. Similar legislation can be found in Australia where farm debt mediation is mandatory in Queensland and New South Wales, and voluntary in Southern and Western Australia.[114] In Canada Farm Debt Mediation Act 1997 provides for the mediation of enforcement disputes.[115]

South Africa provides means to refer credit disputes to mediation instead of debt enforcement. However, there is a differentiation between financial and non-financial institutions as lenders as to whether alternative dispute mechanisms can be employed. According to National Credit Act 34 of 2005 section 134, a person may, instead of filing a complaint with the National Credit Regulator, refer a complaint relating to a credit provider that is a non-financial institution, to mediation, arbitration or conciliation.[116] If the credit provider is a financial institution, the dispute must be referred to the Financial Services Ombud Scheme.[117] In Kazakhstan, 7.2% of the Centre for Mediation and Law's workload deal with credit/debt relationship disputes between banks and clients in relation to loan repayments.[118]

4. Conclusions

This paper suggested that a successful method of incorporating mediation into the enforcement of security interest mechanism may be best achieved via a multi-tiered dispute resolution clause. Parties should begin with a negotiation for an amicable settlement whereby the secured creditor and the grantor negotiate the repossession of the asset. If this fails, the parties should commence mediation proceedings. If mediation proceedings do not yield results then parties will have to resort their dispute to arbitration which provides a binding decision. Since the parties will consent to this type of dispute resolution when signing the loan agreement, the multi-tiered dispute resolution clause may provide the desired results.

It is possible that mediation can be used as an extra-judicial method of enforcement when self-help negotiations prove to be inefficient and where the submission to national courts may lead to the decrease in the value of asset and may prove to be risky due to delays or concerns with regards to bias. However, it is important to ensure that third parties are included in the mediation process. Therefore, it would be useful to provide detailed guidelines that would work for all parties and legal systems as to why and how mediation can work in the context of enforcement of security interests. It may be that a system of small claims courts could be established that exclusively deal with the enforcement of security interests. These guidelines should include a number of crucial points. Firstly, these guidelines should clarify how joinder of third parties (*i.e.* other secured creditors of the grantor) should be achieved in the mediation process without additional burden. Informing third parties to join mediation should be the responsibility of both the grantor and the secured creditor. Mediator is then able to invite these to the mediation hearing and conduct mediation through caucuses. Since the mediator does not have a coercive power to include third parties to the mediation, during this

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[114] http://www.agriculture.gov.au/ag-farm-food/drought/assistance/approach_to_farm_debt_mediation (accessed May 2017).

[115] http://laws-lois.justice.gc.ca/eng/acts/F-2.27/ (accessed May 2017).

[116] T. Broodryk, 'A Developing Mediation Minnow: The South African Perspective' in '*New Developments in Civil and Commercial Mediation Global Comparative Perspectives*' Ius Comparatum-Global Studies in Comparative Law 6, C. Esplugues and L. Marquis (eds), 667, at 675 (Springer, 2016).

[117] http://www.justice.gov.za/mc/vnbp/act2005-034.pdf (accessed January 2016).

[118] F. Karagussov, 'The Legal Framework for Mediation in Kazakhstan: Current State, Expectations of Public Recognition and Perspectives for Development' in '*New Developments in Civil and Commercial Mediation Global Comparative Perspectives*' Ius Comparatum-Global Studies in Comparative Law 6, C. Esplugues and L. Marquis (eds), 393, at 402 (Springer, 2016).

process both the secured creditor and the grantor should work together and consent to the joinder of grantor's third party creditors. A confidential and non-transparent dispute resolution mechanism may compromise third party rights. Therefore these concerns should also be addressed by enabling all third parties to take part in the mediation process. Third parties should not be expected to check the enforcement registry or notices as to whether enforcement has been commenced. UNCITRAL Model Law could be expanded to require the secured creditor to give an express enforcement notice similar to that of the OAS Model Law. Secondly, enforceability of settlement agreement needs to be set in a harmonised framework. Currently, some legal systems treat settlement agreement as if it is a court order. In others either authentication of the settlement agreement by a notary public or by submitting the settlement agreement to the court to render it enforceable as a judgment (*homologation*) are necessary for a binding agreement. Perhaps, this harmonisation can be achieved in a joint meeting with the Working Group II of the UNCITRAL where a draft instrument on enforcement of international commercial settlement agreements resulting from conciliation is being prepared.[119]

For mediation to be successful in secured transaction disputes and particularly in the exercise of post-default rights, it is important to provide required sufficient training to business people and lawyers alike.[120] Access to justice is one of the ideals of article 3(3) of the UNCITRAL Model Law.[121] Karl Llewelyn notes that "the essence of our craftsmanship lies in skills, and wisdoms; in practical, effective, persuasive, inventive skills for getting things done…"[122] This is a crucial observation in that lawyers as well as business people have to be trained in order to improve the quality of mediations or increase the use of mediation in the exercise of post-default rights. And this requires a gradual transition. That transition to be successful there must be a tradition of negotiation and mediation in enforcement related disputes. This cannot be parachuted or created through copy and paste solutions and expected to be implemented in a short period of time. The UNCITRAL Model Law and its provisions have been drafted for all jurisdictions with a varying degree of economic and legal development. This transition requires time and the successful implementation of the UNCITRAL Model Law's fundamental principles.

Finally, it is important to emphasise that there are economic incentives for third parties to participate in the mediation rather than other forms of alternative dispute resolution mechanisms or litigation in relation to the disputes on the enforcement of security rights. Mediation's advantages such as its flexible, cost and time effective, voluntary and consensual nature can be used in the process of expedited enforcement of security rights.

[119] A/CN.9/WG.II/WP.200; A/CN.9/WG.II/WP.200/Add 1.

[120] One of the examples of provision of training can be found at: http://www.natlaw.com/project-areas#promotion_of_alternative_dispute_resolution (accessed May 2017)

[121] A/CN.9/WG.VI/WP.73, para. 74 "It should be noted that paragraph 3 is intended to recognize alternative dispute resolution mechanisms, without interfering with the way in which the various legal systems deal with arbitrability of disputes arising under a security agreement or a security right, the protection of rights of third parties or *access to justice*." (emphasis added).

[122] K.N. Llewelyn, 'The Crafts of Law Re-Valued' 28 *American Bar Association Journal* 801, 802 (1942).