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Mediating with a financially impaired defendant

In employment mediation involving financially strained employers, the focus often shifts from liability and damages to finding viable settlement options, with the success of the mediation depending on the transparency of the defendant's financial situation and the creative, candid approach of both parties.

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When I mediate employment matters, I usually see individual employees asserting grievances against employers who have assets, as well as insurance coverage, to protect themselves against such legal challenges. Their cases will typically focus on the defendant's liability and/or the damages they have suffered - issues that tend to be straightforward and relatively simple to assess.

But what happens if the defendant employer has neither insurance nor sufficient funds to effectuate a settlement? Instead of focusing on the merits of the employee's claim, the parties - and their mediator - may find themselves quickly shifting into an exercise in determining from whence any potential settlement funds might come.

How did we get to mediation in such cases?

A financially challenged employer who has been sued by an employee could find itself in a veritable Catch-22 scenario. A small business, for example, might have been successfully managing its business but also operating under extremely tight profit margins with little excess capital. A larger company - apparently quite successful - could be anything but healthy. One look under the hood might reveal that it is actually struggling to stay afloat.

In either case, that employer now finds itself subject to a lawsuit from which it will be unable to extricate itself short of going to trial. On top of that, counsel may have persuaded company management to sign an arbitration agreement that will require payment of six figures to a private arbitrator. Add to this a litigation budget projected to be several hundred thousand dollars. This is just the minimum they could end up paying for the chance of trying to win the lawsuit.

And if they should ultimately lose the action, they will pay damages to the plaintiff, as well as a sum in attorneys fees that could approach seven figures. Even the smallest case could end up being devastating to a financially struggling defendant.

How should this defendant approach mediation?

So how to approach mediation when the deck is so heavily stacked against the defendant? Defense counsel has basically three options for approaching mediation on behalf of a financially challenged client. Two of these approaches will undoubtedly result in a failed mediation.

Approach One: Simply say nothing and roll into the mediation as though there are no financial problems. Under this approach, defense counsel allows the mediation to move forward as if everything is normal, with the parties arguing over damages and liability and - at some point in the day - starting to exchange numbers.

Only as the day has worn on and the parties are getting close to a mutually agreed number does defense counsel suddenly announce that any agreed-upon payment will

have to be structured in installments over the course of several years. As one might imagine, this tactic rarely works. Plaintiff's counsel now feels sand-bagged, telling the mediator that the defense is acting in bad faith. He has not been provided with any proof of the defendant's alleged precarious financial position and he cannot advise his client to accept such payments. If his client were to agree to a payment plan, the demand would have to go up to offset the delayed payments.

The mediator is suddenly put in the position of trying to hold the process together. Any goodwill that was developed throughout the day has suddenly disappeared. In short order, one the parties will storm out and the mediation will be aborted.

Approach Two: Defense counsel shows up on the day of the mediation and, for the first time, at the outset of the mediation, announces to the mediator that her client does not have sufficient funds; the mediator will have to go into the plaintiff's room and convince the other side to accept a small settlement or face the prospect of no money down the road. This approach may be accompanied by a threat to close the doors or go down to bankruptcy court the next day and file Chapter 7 or Chapter 11 bankruptcy. The shock in the room may not be as great as under the first scenario, but it is bound to result in some brinkmanship. The end result will be the same.

Approach Three: Defense counsel understands his client's dire circumstances and alerts plaintiff's counsel in advance of the defendant's precarious financial condition. He assures plaintiff's counsel that the defendant will share all relevant information before the mediation. Although this last approach is truly the best and only way a mediator can successfully navigate the turbulent waters of a financially challenged mediation, in the real world it is seldom used.

How does a defendant prove hardship?

When a defendant asserts financial hardship during a mediation, the burden will be on that defendant to help the plaintiff's attorney understand the legitimacy and seriousness of the issue. It will not be enough to simply allege financial inability to pay without proof, and no plaintiff's counsel can properly advise a client in the absence of evidence; to do so could constitute malpractice. Some plaintiff's counsel will actually walk out of a mediation if bald assertions of financial hardship are not backed up by evidence.

The proper approach is, therefore, to provide both the mediator and plaintiff's counsel with proof of the defendant's financial condition. It will not be as simple as a P & L statement generated on Quicken. Experienced counsel will demand a number of documents, including a check register, tax returns for individual owners and corporations, savings accounts, receivables, payables, loans, compensation reports, and CPA notes. All of these documents will go a long way toward proving to plaintiff's counsel that pursuing litigation will ultimately result in a limited or no recovery. Most attorneys do not want to find themselves chasing a large judgment with no hope of collection. A well-known collection attorney once told me that "a judgment is just a hunting license."

How does a mediator successfully navigate rocky finances?

Before every mediation, the mediator should set up a call with each side. In my practice, I always insist on separate 30-minute calls with both sides to discuss a range of issues such as the status of negotiations, the nature and extent of insurance, and - most importantly - whether the defendant will be pleading an inability to pay. If this is the case, I will want to know whether this information has been communicated to the plaintiff's counsel.

Defense counsel may be understandably reluctant to disclose financial records that are outside the scope of the discovery process. In cases where there may be bad blood between lawyers, defense counsel may not want to voluntarily give a client's private records to an allegedly unscrupulous opposing attorney. In such instances, parties may instead ask to share their records with the mediator, a neutral party who is not an advocate for either side. This approach could, however, end up affecting the neutrality of the mediator, and not all mediators are equipped to parse out and understand the nature of financial records.

When a defendant is unwilling to share records, the mediator might consider creating a mediator's proposal based upon the value of the claim and the parties' negotiations. That proposal can then be left open to give the defendant sufficient time to seek a line of credit or a loan. This approach may work well in those situations where a successful business has no available capital to pay a large lump sum.

If a defendant cannot get the plaintiff or plaintiff's counsel to recognize a financially precarious situation, it may make sense to threaten filing bankruptcy. Even though such threats are often hollow, they may carry more weight when defense counsel brings bankruptcy counsel to the mediation. Bankruptcy counsel can lay out for plaintiff's counsel the impact of a bankruptcy filing on the pending mediation, forcing the case to be transformed into an adversary action with a potential limitation on jury trials and on the types of penalties normally available to an employee under California law.

Conclusion

As businesses of all sizes face financial constraints, their ability to satisfy legal judgments or negotiated settlements becomes attenuated. Mediation offers a less onerous path toward resolving employment disputes, but it may require both candor and creativity from both sides. The earlier that the mediator and plaintiff's counsel understand a defendant's financial position, the better prepared everyone will be to negotiate a fair and workable payment plan.

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