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# Securities Law

## Derivatives Law

### Mediation

## Mediation—Coming to a Financial Services Dispute Near You: Legislation, Regulation, and Economics Will Drive the Trend to Mediation in 2012

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*Contributed by V. James Mann, JAMS*

In 2012, we no doubt will see the continuation of a significant trend towards the use of mediation to resolve financial services disputes. A perfect storm of economic, legislative, and regulatory conditions has been created with the potential to affect profoundly the likelihood that mediation will assume a larger role in the resolution of cases involving the financial services industry. Couple this with the fact that the average time between filing and disposition of civil cases in federal district court is over two years, and it becomes more likely that parties will take the mediation route more often.

This article analyzes the current conditions affecting how financial services disputes are handled and provides guidance on using mediation effectively.

### Recent Developments Will Add to the Pressure to Settle

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) has brought into question the continued viability of pre-dispute arbitration agreements, increasing the probability that securities customer litigation will be filed in court.[1] Furthermore, the assault on pre-dispute arbitration agreements is being waged on other fronts as well.

Dodd-Frank flatly prohibits such agreements in residential and home-equity loans, and for certain whistleblower claims of securities fraud and commodities fraud. On November 21, 2011, the Financial Industry Regulatory Authority (FINRA) proposed an amendment to Rule 13201 of its Code of Arbitration Procedure to align the Rule with statutes that invalidate pre-dispute arbitration agreements for whistleblower claims. Dodd-Frank also requires the new Bureau of Consumer Financial Protection to conduct a study on the use of pre-dispute arbitration agreements in consumer financial services cases and gives the Bureau the authority to limit or prohibit such agreements.

Past legislative attempts to restrict pre-dispute arbitration agreements may foreshadow an increase in more costly and time-consuming lawsuits. The Arbitration Fairness Act of 2007[2] was intended to amend Section 2 of the Federal Arbitration Act to provide that "no pre-dispute arbitration agreement shall be valid or enforceable if it requires arbitration of (1) an employment, consumer, or franchise dispute; or (2) a dispute arising under any statute intended to protect civil rights or to regulate contracts or transactions between parties of unequal bargaining power."

The Fair Arbitration Act of 2007[3], however, took a different approach. Rather than outlawing any category of pre-dispute arbitration agreements, it imposed significant restrictions on the form and substance of arbitration, in many ways making arbitration much more like the court proceeding it was intended to streamline and replace. Although neither of these legislative proposals ultimately was enacted into law, they evidence a

renewed congressional and regulatory interest in oversight of consumer disputes, including disputes with financial services providers. Dodd-Frank and the proposed amendment to FINRA Rule 13201 are the heirs-apparent.

It remains to be seen what path arbitration reform legislation and regulation ultimately will take. It is, however, likely that new laws and regulations will affect arbitration practice in meaningful ways. To the extent this results in a migration of more cases to the courts, it will increase the (a) time from filing to resolution of disputes, (b) cost of litigation as cases become subject to motion practice and increased discovery, and (c) risk of an all-or-nothing resolution as cases increasingly are determined on the basis of legal, rather than equitable, principles. Like most things, an increase in the cost of litigation–whether measured in time, money or uncertainty–will increase a desire to avoid the process, and will tend to favor settlement over adjudication.

## Compromise Is Not a Dirty Word

In 2008, the Journal of Empirical Legal Studies published a study that analyzed more than 2,000 California cases in which one party rejected the other's final settlement demand or offer and proceeded to arbitration or trial.[4] The authors sought to determine whether such parties achieved better results through arbitration or trial than the last offer they rejected.

Ignoring the time, costs, and fees associated with further litigation, the authors discovered that plaintiffs actually received an award equal to or less than the defendants' last offer in 61.2 percent of the cases, with a verdict that was on average $43,100 less than the last offer. Defendants generally performed better after trial or arbitration, but in the 24.3 percent of cases where they performed worse, they paid an average $1.140 million more than they could have settled for. The authors validated their results by expanding data from California to New York with consistent results.[5]

The study strongly suggests that settlement, while it represents compromise, is often not a decision to accept "half a loaf," but may be an agreement to accept a whole loaf, or more.

## Maximizing the Prospect for a Successful Settlement Process

For any number of reasons, litigants often find themselves unable to negotiate a resolution of their dispute successfully without the assistance of an impartial mediator. A decision to mediate is an implicit acknowledgment that traditional settlement strategies and tactics are not likely to result in a satisfactory settlement.

In 2006, the American Bar Association Section of Dispute Resolution issued the results of a study that addressed issues of quality in mediation[6]. The study concluded that four issues are important to a successful mediation:

- Preparation by the mediator, parties, and counsel;
- Case by case customization of the mediation process;
- Analytical assistance from the mediator; and
- Persistence by the mediator.

The first two of these issues are the province of counsel, at least as much as they are the mediator's responsibility. They underscore the fact that the parties "own" the mediation and should try to structure the process in a way that will maximize the chance of success, limited only by their collective imaginations. Strict adherence to the traditional negotiation approach may result in a missed opportunity to optimize the prospects for a good settlement.

For example, where both sides recognize early in the process that a case should be settled, or there are cost or time considerations–such as an ill or elderly client, or a commercial relationship that needs to be restored as soon as practicable–they may decide to engage in limited, expedited discovery as part of the process to expedite resolution. The level of knowledge necessary to evaluate a case for settlement purposes and persuade your adversary of the fairness of your position is often not the same as the level required to prove a case at trial. If necessary, a skilled mediator can assist the parties in structuring a limited discovery process so that intelligent, informed discussions can follow. One commentator has noted that "80 percent of the relevant information that parties learn from discovery often comes from the first 20 percent of the money they spend. Tracking down the last, difficult-to-obtain data is the most expensive part of discovery. . . . If parties conduct initial core discovery, they may find all they need to know in order to resolve the case appropriately."[7]

Once the parties have developed sufficient information to embark on the mediation itself, several threshold issues must be resolved. One of the first questions, and one of the most important, is who should attend. It has been said that CEOs settle more cases than Vice Presidents because, among other things, a more senior representative is less likely to be concerned about later criticism of his decisions and may be better able to take a global view of the dispute.[8] In addition, a more senior corporate representative is less likely to have been involved personally with the underlying dispute, and may not have the same emotional stake in a compromise. In certain situations, a company may not be able to make a deal without permission from its insurer, so it is important that a representative from the insurance carrier be present or available to bless any settlement. Similarly, an individual party may feel it necessary to consult a spouse or other family member before agreeing to a settlement, or counsel may conclude that the presence of a spouse may temper a client's combative instincts. Failure to ensure that the appropriate decision-makers are involved can delay or even sabotage a settlement.

Mediation is a process, and must proceed at its own pace if it is to be successful. This may be the first time a more dispassionate senior representative of one or more parties has focused on the dispute in a concrete manner, and generally it is not productive for the parties to begin exchanging offers until there has been an opportunity to work through important issues in the case. One reason many cases settle "on the courthouse steps" is that an

impending trial may be the first defining event before parties and their lawyers get serious. Mediation can offer a similar kind of focus to both sides. Consequently, the client, who may never have participated in a mediation, should be informed in advance that hard bargaining may not take place until after several caucuses with the mediator and that he should be neither surprised nor discouraged if initial proposals seem unrealistic.

Once the ground rules have been established, the participants identified, and the clients told what to expect and how to behave, other pitfalls may remain. For example, many attorneys shy away from opening statements in a joint session because they feel such presentations only inflame the clients or that there is no benefit to restating the parties' positions, which are well known to both sides. One reason for concern about inflaming the clients may be that opening statements often are directed primarily at the mediator, much like an opening statement to an arbitrator or jury. However, the "jury" you should be trying to persuade with an opening statement actually is your adversary. Poisoning the well with an inflammatory opening statement is rarely a good idea.

Although no hard and fast rule can be applied, a reasoned summary of the facts supporting your position and the impact the dispute has had on your client can be effective in setting a tone which may be useful in settling the case. While a strong opening statement by your adversary may offend your client, the experience of directly speaking to an opponent can help the parties let go of emotions that could impede later decision-making. Unless your client is particularly inarticulate or unappealing, you may wish to have the client participate with a well-prepared opening statement. The mediation may be the first opportunity your adversary-representative or counsel has had to see your client, particularly if there have been no depositions in the case. People pay more to, or accept less from, a party who will make a good impression on a fact finder.

If, in spite of everything, the case does not settle at the mediation session, all is not lost. A good mediator will continue to try to find a way to a settlement until the parties tell him categorically to stop and he concludes there is no plausible way to change their minds. Therefore, you should do everything possible not to close the door too firmly when leaving an apparently unsuccessful mediation session. At minimum, you should leave in a professional and respectful manner. Good manners cost nothing, and the client who walked in the door determined to crush the other side may leave with a more conciliatory perspective if he feels the negotiations were conducted respectfully and in good faith. It also may be productive to agree that you will keep talking, perhaps after some additional discovery, if you feel you need more information than anticipated when the mediation began. The mediator also can be a valuable ally in obtaining a favorable response to a reasonable discovery request, if it seems likely to advance settlement prospects.

## Conclusion

Almost nine out of 10 civil cases will be settled rather than tried. Whether a given case settles in a way both sides perceive as fair has a lot to do with the degree of care brought to structuring the process, as well as the facts and the law involved in the dispute. Good luck is the handmaiden of hard work, and the outcome of a mediation can be affected substantially by the preparation and persistence of the mediator, the parties, and their counsel.

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[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203 § 921(a), 124 Stat. 1376 (2010).

[2] Arbitration Fairness Act, H.R. 3010, 110th Cong., § 4 (2007).

[3] Fair Arbitration Act, S. 1135, 110th Cong. (2007).

[4] "Let's Not Make A Deal: An Empirical Study of Decision Making in Unsuccessful Settlement Negotiations". Journal of Empirical Legal Studies, Vol. 5, No. 3 (Sept. 2008), pp. 451-591, available at http://www.blackwellpublishing.com/jels.

[5] *See* Linda R. Singer, "Preserving Value Through Mediation," Law360 (Aug. 16, 2010), available at http://ww.jamsadr.com/files/Uploads/Documents/Articles/Linda%20Singer%20/Preserving%20Value%20Through%20Mediation.pdf.

[6] http://www.abanet.org/dispute/documents/FinalTaskForceMediation.pdf.

[7] Jeffrey M. Senger, "In Practice: Tales of the Bazaar – Interest-Based Negotiation Across Cultures." 18 Negot. J. 233 (2002).

[8] This is not to suggest that it is desirable, or even possible, to have the head of a major company attend every mediation.