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PERSPECTIVE

Disclosing financial data in mediation

By Lou Marlin

More frequently than one might expect, the financial status of a defendant becomes a critical issue in a mediation. This can be particularly true when either there is a complete lack of insurance that would cover the event/injury involved, or the applicable insurance coverage is likely inadequate to cover the claims by the plaintiff. Either of these situations often result in the need for a review of business financial records to justify settlement offers below a reasonable value for a case.

The situation involving a complete lack of coverage is relatively obvious. With no coverage, the defendant must look to its own assets and cash flow to resolve a case, and a claim of financial stress clearly becomes a factor in settlement discussions. In the second situation, when there is coverage for something less than the full value of the claim, if a defendant claims a lack of financial ability to contribute to a settlement beyond the insurance coverage, the company's financial standing likewise becomes an issue.

The challenge faced by litigators is when and how this issue should be addressed in connection with a mediation. Simply put, there is often a strong and understandable reluctance to permit opposing counsel to review a client's financial records until absolutely necessary. Thus, some defense attorneys appear to favor withholding that their client is financially challenged, as well as the specifics of the same, until the mediation itself, springing the information on opposing counsel as if it is a settlement argument in defense counsel's client's favor, rather than an impediment to resolution. I would argue that is a serious mistake that can clearly jeopardize the chance for a successful outcome, and often results in unnecessary second or follow-up mediation sessions.

In most situations, I would counsel a multi-step process to disclosing the details of a defendant's financial challenges to opposing counsel. First, at a reasonable time prior to the mediation, plaintiff's counsel should be informed that the financial status of the defendant, and its ability to pay all or part of a settlement, will be an issue. It is not necessary at this time to go into great detail, but it is important to building and maintaining trust with the other. Once the existence of financial challenges has been disclosed, one of two following steps should be taken.

In the relatively rare situation where the financial records are uncommonly complex and may require review by an accountant, the parties should consider agreeing to the defendant providing the same prior to the mediation under the protection of the mediation privilege (Evidence Code Section 1119). The parties can, and should, agree to specific terms as to how the information is handled, and who may review the same. The parties may agree to provide the information to a neutral accountant for review, with a report being provided to both sides, and the actual specifics being withheld from the plaintiff. By example, an independent accountant may be asked to only provide an opinion as to whether or not the defendant lost money in the previous year and, if so, the extent of that loss. That may be sufficient information for the plaintiff's counsel to be satisfied that there is a real issue as has been represented.

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However, in the majority of cases, and for many cautious defense counsel, this might be a step too far (and unnecessary) as they feel there is no valid reason to disclose the details of their client's financial condition unless and until a settlement has been reached. In those situations, and in the case of less complicated financial records, I encourage the parties to bring a copy of the records to the mediation. At the mediation, the defense counsel should make a clear representation about those specific aspects of his client's financial condition (be it insurance coverage, cash flow challenges, etc.) that the attorney feels will impact the settlement process. This should be done quite carefully, with the clear knowledge that the statements will be verified by a review of financial documents at the end of the mediation.

With the representation having been made, the parties should be able to commence their discussions with an eye toward settling the case. The situation has a certain amount of built-in tension, as the plaintiff's counsel may want to continue arguing to recover what he/she sees as the full value of the claim, regardless of the impact on the defendant. It is the job of a good mediator to make it clear that it is unlikely that a defendant would jeopardize its corporate existence to satisfy a claim via settlement, and that a reasonable accommodation must be made for the defendant's financial challenges.

If a settlement is reached, it is tentative, subject to a review of the defendant's financial records, including its balance sheet and profit and loss statements. What I have done in these situations is to encourage plaintiff's counsel to make sure that he/she will be capable of reviewing the financials at the mediation or, if not, having someone present who will be able to do so. In many cases, the defense will not be willing to permit the plaintiff or his/her attorney to make copies of the financial records, and the solution to this is to make sure the review can be conducted at the very end of the mediation. The plaintiff's attorney meets his or her obligation to his or her client by conducting this review at this time and verifying the representations made by defense counsel.

In my experience, I have not seen a settlement fall apart using this technique because the representations made by defense counsel prove to be untrue. Since defense counsel have an ethical obligation to make honest and accurate representations to opposing counsel that opposing counsel may rely upon in connection with the mediation, factually accurate and unadorned information is what is normally shared with plaintiff's counsel.

By breaking the mold of hiding a defendant's financial challenges, which would impact its ability to resolve a case until the commencement of the mediation, greater opportunity for success is possible. The proposal set forth in this article requires the cooperation of counsel for the benefit of each side's client.

LOUIS M. MARLIN
JAMS

Louis M. Marlin *is a full-time neutral with JAMS. He specializes in a variety of disputes, and is adept at handling large, complex cases, including matters involving class action, mass tort, employment and personal injury issues. You can reach him at lmarlin@jamsadr.com.*