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Resolving and Settling Claims in the Financial Services Industry Through Mediation

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Mediation, which is voluntary, can be used to resolve complex disputes involving multiple financial institutions.

The financial crisis has produced, and continues to produce, a significant amount of litigation among members of the financial services industry. The enormous costs of litigation have prompted many parties to pursue alternative dispute resolution procedures, including mediation. While no one method of resolving disputes will eliminate the litigation overhang, prudent use of mediation can—and has—resolved disputes quickly, efficiently and fairly.

Overview of Mediation

Mediation is an alternative dispute resolution procedure in which parties negotiate voluntarily through a mutually selected mediator or neutral in lieu of litigation. Although mediation is an entirely consensual and private process, if successful, it can produce binding agreements. Such agreements will generally be in the form of a contract and will be legally enforceable. Parties often prefer to mediate disputes in order to avoid the costs of litigation, to negotiate in a private atmosphere and to reach fair and effective outcomes in a brief period of time.

Mediation services in the United States are provided principally by JAMS and CPR. Mediators can be selected from JAMS Panels (*www.jamsadr.com*); CPR International Institute for Dispute Resolution Panel of Distinguished Neutrals (*www.cpradr.org*); or from the American Arbitration Association (AAA), which maintains a roster of approximately 8,000 neutrals, each with at least eight to ten years' experience in their respective fields.[2] Also, mediation service providers often have their own sets of rules and guidelines and offer form documents to assist in mediation.[3]

Mediation may be used in almost every type of dispute or transaction, ranging from a simple small claims case to the most complex commercial disputes between large institutions. Mediation as an industry has grown over the years from being confined to a few specialized fields to being effectively applied in almost any legal dispute.[4] As will be discussed further in the context of mediation methodology, success rates and timing, mediation can offer a fair, effective and quick alternative to traditional litigation for members of the financial services industry.

Complications of Litigation

Disputes arising out of the financial services industry are often incredibly complex. Participants in such disputes range widely, involving commercial banks, investment banks, brokerage firms, investment managers, asset managers, insurance companies, institutional investors and retail investors. Types of claims may include breach of contract, breach of

fiduciary duty, unjust enrichment, fraud, negligent misrepresentation and federal securities laws violations. Due to the complexity of such disputes and because of the nature of litigation, litigants are often subject to oppressive demands on their time and resources in pursuit of resolution.

As of September 30, 2009 (the most recent statistical information available), the average disposition time of a civil action commenced in a U.S. District Court through the completion of any appeal to the Circuit Courts was 32.4 months.[5] For the same time period, cases litigated through trial before U.S. District Courts, without taking into account time for appeals, were disposed of on an average of 23.4 months from date of filing.[6] Civil litigation in state court varies depending upon the method by which the case is decided. Cases tried by a jury took, on average, 26.6 months from filing to disposition, while bench trials were disposed of in an average of 20.8 months.[7] Every litigation presents the same issues of delay, cost and publicity that draw the attention of shareholders and regulators, and faces a 100-percent–win/lose outcome. Below are examples of some of the complications litigation can present.

Bank of New York v. First Millenium, Inc.

Financial services industry cases often raise complex issues involving detailed agreements among multiple parties. Such cases often have complicated procedural histories as well, and involve excessive costs and delay for all parties. An example of such a case is Bank of New York v. First Millennium, Inc.[8] Here, Bank of New York (BONY), in its capacity as indenture trustee, commenced an interpleader action against private institutional investors and the Federal Deposit Insurance Corporation (FDIC) to determine the outcome of competing claims against the assets BONY held. BONY held the assets in dispute in a trust established by NextBank, N.A., created in connection with a securitization transaction involving credit card receivables.

The BONY case was decided on June 1, 2010, but its procedural history goes back as far as June 5, 2003 when BONY initially commenced suit against the FDIC (NextBank's receiver), on behalf of its trust's noteholders (the private institutional investors). BONY claimed that the FDIC had unlawfully converted funds to which the noteholders were entitled by refusing to honor the *ipso facto* clause of the master indenture, which provided for accelerated principal repayment in the event NextBank was placed in receivership. The FDIC responded by saying it could disregard the provision under the Financial Institutions Reform, Recovery, and Enforcement Act, and the D.C. District Court agreed.

Despite the decision, certain noteholders demanded that the trust assets be distributed to them anyway and raised new facts to support this conclusion. BONY responded by filing an interpleader action in New York state court, which was removed by the FDIC to the United States District Court for the Southern District of New York. A number of motions for summary judgment, venue transfer and interpleader injunction followed, but such motions were denied. The Court determined that BONY's remaining trust assets belonged to the noteholders, but the FDIC appealed. Finally, the Second Circuit confirmed that the noteholders, not the FDIC, had valid claims to the trust assets. However, it took close to seven years of litigation to reach this result and the outcome was 100-percent–win/lose.[9]

MBIA Insurance Corporation v. Royal Bank of Canada

Adding to the inherent complications of litigation, the products and agreements in dispute can be extremely complex themselves. For example, sophisticated derivatives products like credit default swaps (CDS) embody complex provisions and arrangements that present difficult problems to the courts in resolving these disputes. In MBIA Insurance Corporation v. Royal Bank of Canada[10], MBIA Insurance Corporation (MBIA) brought claims against the Royal Bank of Canada (RBC) and its affiliates, contending that it had misunderstood the substantial risk it was insuring. MBIA claimed RBC and its affiliates were responsible for creating this misunderstanding through fraud. MBIA claimed that RBS failed to provide legitimate "high grade collateral" and instead selected deteriorating collateral with deficient subordination protection, while procuring inflated credit ratings. RBC responded that MBIA willingly and knowingly assumed larger risks in exchange for larger fees, and was only now trying to use the court system to avoid billions of dollars of contractual obligations.

MBIA acted through a subsidiary, LaCrosse (as credit protection seller), in entering into three CDS transactions involving collateralized debt obligations (CDO) with RBC. MBIA guaranteed Lacrosse's obligations through Financial Guaranty Insurance Policies to provide coverage in the case LaCrosse failed to pay its obligations under the CDS contracts. The CDS transactions were each documented by an ISDA Master Agreement, a Schedule, and a Confirmation. MBIA and RBC also entered into Verification Agency Agreements with Deutsche Bank AG, which was responsible for issuing Verification Notices that verified RBC Credit Event Notices. Furthermore, MBIA sought to include other RBC entities, which were not signatories to the CDS contracts, in the litigation because of their role in marketing and negotiating the CDS contracts--but claims against these entities were dismissed because they were not signatories to the relevant contract. Again, regarding MBIA's claims against the other RBC entities, this was a 100-percent–win/lose outcome that could have been avoided through effective mediation.

MBIA's principal complaint was that RBC misrepresented the credit quality of the CDO's collateral, which involved hundreds of underlying securities and tens of thousands of loans. RBC moved to dismiss MBIA's nine causes of action, and the Court granted the motion on six of them. Causes of action for fraud, fraudulent concealment, and aiding and abetting fraud survived, however. The dismissal proceeding was preceded by a 33-page opinion regarding the appropriate venue for the case and the order dismissing six of the nine causes of action was 29 pages. The Court considered ten sets of papers in connection with making a determination regarding the motion to dismiss. The sheer volume of documentation linked to the complex arrangements of the CDS contract in dispute will likely lead to an immense drain on resources before any resolution is reached. The surviving causes of action are still being litigated.[11]

In re Parmalat Securities Litigation

Settlement agreements pursued in the context of complex litigation, sometimes involving multiple suits occurring simultaneously among overlapping parties, can pose additional problems of delay. In many instances, settlements between two parties may have unintended, and indeed unfair, effects on non-settling parties who are involved in the overall litigation scheme. For example, in In re Parmalat Securities Litigation[12], plaintiff Bondi (whose role was similar to a

bankruptcy trustee for Parmalat) and auditor defendants Grant Thornton International, *et al*. entered into a settlement agreement with respect to a complex litigation involving multiple parties in multiple forums tied to the collapse of the Parmalat dairy conglomerate. However, non-settling defendants, mainly deep-pocket banks and corporations, vigorously protested the credit formula used in the settlement as unfair to them.

Settlement negotiations began after almost two years of discovery, and in fact there was a mediation within the context of the litigation. However, the mediation focused solely on one dispute among a series of Parmalat litigations that shared many core issues. The settlement reached applied only to the parties in the specific case at hand and barred non-settling parties' claims for contribution under Illinois law. In pursuit of a fair result, the non-settling defendants in other suits filed by plaintiff Bondi sought to receive a judgment credit from the settlement under the proportionate share method. After conducting a complex choice of law analysis, the Court held that Italian law should be applied and adopted the capped proportionate share method that the non-settling defendants sought. The Court determined that since plaintiff Bondi had settled with the settling defendants at a deep discount from his original damages assertions, it would be entirely fair to give non-settling defendants a judgment credit equal to the settling defendants' proportionate share of jointly inflicted damages on Parmalat.

This case is an example of how simultaneous suits involving overlapping parties can complicate claims and settlements that do not neatly fit into separate litigation proceedings. Thus, even if parties engage in mediation, it should be as comprehensive as possible to avoid an outcome that is unfair to other related parties. Constant adjustments may have to be made, and all such adjustments tax court resources and require a commitment of excessive amounts of time and money.

Mediation Methodology, Success Rate and Timing

Is there a better way to resolve these disputes? The short answer is: try mediation. Disputes among financial industry players share characteristics that can be accommodated in mediation such as highly complex documentation, multiple parties and the need to apply law to ambiguous contracts. In mediation, the parties, with help from a skillful mediator, can fashion a solution taking into account these characteristics. Furthermore, mediation seeks to avoid future conflict among overlapping parties and disputes through a comprehensive approach at the outset. What follows is an overview of mediation methodology and a discussion of its merits in terms of success rate and timing.

Methodology

As discussed previously, mediation is voluntary: parties are required to agree in writing, whether prior to the dispute or, if no prior written agreement exists, through a written mediation agreement.[13] Very generally, the mediation process starts with a joint discussion of the case and is followed by the mediator working closely with the parties, either separately or as a group, to resolve the case.[14] The parties make written submissions to the mediator -- similar to a pre-trial brief -- but considerably shorter and with limited caselaw development.

The mediator acts as facilitator—and sometimes as a challenger to the preconceived notions of each side—working to prevent any new disagreements and guiding the parties to an acceptable solution that does not result in either side achieving a 100-percent "victory" as that term is used in the context of litigation. Mediation allows for considerable flexibility in achieving mutually beneficial outcomes and the private nature of the proceedings can facilitate swift resolution. If the mediation is successful, the terms of the agreement should be incorporated into a Memorandum of Understanding (MOU).[15]

A skillful mediator is critical to the process. When selecting a mediator, ask: Who do you want your mediator to be? A person with extensive mediation process expertise? Or a person with financial services and/or credit markets expertise? Ideally, the mediator would possess both, but which qualification, if any, do you want to specify in writing in a mediation clause? Given the complexity of the documents constituting the various agreements between and among multiple parties, requiring the mediator to be a lawyer is a given.

For particularly complex disputes, such as those often presented by the financial services industry, there are many instances when an expert can greatly assist in the mediation process. The expert might be engaged by one party for the benefit of a negotiated resolution endorsed by all parties or the expert might be engaged jointly by the parties to serve as a neutral advisor to the mediator. An expert can identify the core issues in dispute, isolate unimportant facts and identify areas of mutual agreement. An expert can be an invaluable resource for the mediator and the parties in understanding the central facts and issues and in saving a great deal of time.[16]

Success Rate and Timing

Approximately 85 percent of commercial matters submitted to mediation result in a written settlement agreement.[17] This is a reflection of the parties' willingness to consider an alternative to litigation and the skill of the mediator. However, despite the convincing percentages of mediations resulting in settlement agreements, one is lead to ask the question, does mediation indeed achieve results that are preferable to litigation? Empirical evidence seems to suggest that it does.

As Linda Singer, a mediator and arbitrator with JAMS, points our in her article "Preserving Value Through Mediation,"[18] Randall Kiser of DecisionSet in Palo Alto, Calif., and Martin Asher and Blakely McShane of the Wharton School published a study in 2008 that analyzed more than 2,000 California cases in which one party rejected the other's final demand or offer and proceeded to arbitration or trial. In "Let's Not Make a Deal: An Empirical Study of Decision Making in Unsuccessful Settlement Negotiations," 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 trial (which can be very significant, as previously discussed), the authors compared the proposed settlement numbers with the eventual verdicts. They discovered that plaintiffs actually received an award equal to or less than the defendant's last settlement offer in a *majority* of cases (61.2 percent), with a verdict that was on average $43,100 less than the last settlement offer. Defendants generally performed better at trial

or arbitration, but in the 24.3 percent of cases where they performed worse, defendants paid on average $1,140,000 more after trial than the last settlement offer. The authors validated the results by expanding data from California to New York, with consistent results.[19]

Skillful mediators can minimize the risk of the unsuccessful results described in the study, and preserve value for all parties involved. A skillful mediator can present creative and realistic solutions and remove as much emotion and irrationality from the equation as possible. As a challenger, a mediator can balance each party's expectations and encourage objective thinking in reaching a resolution that is acceptable to all those involved. The mediator can also emphasize to each party the immense costs the alternative of litigation would present in reaching what, in the end, should be a compromise.

To that effect, mediation conferences can be scheduled very quickly, with cases generally taking several days over a period of two to four months to resolve.[20] Of course, the time it takes to resolve the dispute depends on the facts of the case, as well as on the willingness of the parties to work together to reach an amicable solution. However, as a general matter, mediation poses far less of a drain on a party's time and resources than litigation, with all of its motions and appeals, on average, would otherwise present.

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[1] This article discusses mediation as a form of alternative dispute resolution, which can often result in settlements as a form of resolution. It does not discuss settlements in the context of class actions or unassisted settlement discussions between two parties.
[2] *See* AAA, *A Guide to AAA Disaster Recovery Claims Mediation Procedures, available at www.adr.org/si.asp?id=3775.*
[3] *See* Exhibits 1 and 2.
[4] THE PRACTICE OF MEDIATION, Douglas N. Frenkel and James H. Stark (Aspen Publishers: New York, NY 2008), p.1.
[5] *See* Median Time Intervals in Months for Merit Terminations of Appeals Arising from the U.S. District Courts, by Circuit, During the 12-Month Period Ending September 30, 2009, Table B-4A, *available at http://www.uscourts.gov/Statistics/JudicialBusiness/JudicialBusiness.aspx?doc=/uscourts/Statistics/JudicialBusiness/2009/appendices/B04ASep09.pdf.*
[6] *See* U.S. District Courts—Median Time Intervals From Filing to Disposition of Civil Cases Terminated by District and Method of Disposition, During the 12-Month Period Ending September 30, 2009, Table C-5, *available at http://www.uscourts.gov/Statistics/JudicialBusiness/JudicialBusiness.aspx?doc=/uscourts/Statistics/JudicialBusiness/2009/appendices/C05Sep09.pdf.*
[7] *See* Lynn Langton, M.A., and Thomas H. Cohen, Ph.D, *Civil Bench and Jury Trials in State Courts*, 2005 (Revised April 9, 2009), Office of Justice Programs, Bureau of Justice Statistics (Oct. 2008), *available at www.ojp.usdoj.gov/bjs/pub/pdf/ cbjtsc05.pdf*. There are significant variations in the length of time required to pursue a claim in courts and in the 50 separate state courts. These differences should be carefully considered before pursuing litigation.
[8] 607 F.3d 905 (2d Cir. 2010).
[9] *Id*.
[10] 2010 WL 3294302 (N.Y. Sup. Ct. 2010).
[11] *Id*.
[12] 2007 WL 541466 (S.D.N.Y. 2007).
[13] *See* Exhibits 3 and 4.
[14] *See* JAMS, *A Guide to Mediation for Lawyers and their Clients* (2003), *available at www.jamsadr.com/mediation/guide.asp.*
[15] *See* Exhibit 5.

[16] *See* Roger M. Deitz, *Experts in Mediation: Catalysts for Resolution*, *available at http://www.sacarbitration.com/experts.htm*
[17] *See* AAA, *A Guide to Mediation and Arbitration for Business People*, Sept. 1, 2007, at 2, *available at www.adr.org/si.asp?id=4121*.
[18] *See* Linda R. Singer, "Preserving Value Through Mediation," Law360 (August 16, 2010), *available at http://www.jamsadr.com/files/Uploads/Documents/Articles/Linda%20Singer%20-%20Preserving%20Value%20Through%20Mediation.pdf.*
[19] *Id*.
[20] *See A Guide to Mediation*, *supra* note 11, at 3.