

PART 2 OF 2

Southern District Establishes Standards for 'Good Faith' Participation in Court-Ordered Mediation

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The *A.T. Reynolds & Sons, Inc.* decision reverses the bankruptcy court's order holding the secured lender in the underlying bankruptcy proceeding, and its counsel, in contempt for failing to mediate in good faith and imposing sanctions upon them. The decision not only vindicates the lender and its counsel for its "no pay" position taken at the mediation, but also articulates a clear and objective standard for parties' future "good faith" participation in a court-ordered mediation.



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Part I of this article traced the history of court-ordered mediation in the U.S. Bankruptcy Court for the Southern District of New York and discussed the difficulties in defining "good faith" in the context of court-ordered mediation. It noted that the cornerstone of good faith participation in mediation is the presence of a corporate representative, and that the failure to reach a settlement should not demonstrate bad faith as parties are neither obligated to make an offer to pay money nor to accept an offer, as the ultimate authority to settle a case belongs to the parties.

Despite Second Circuit case law, which has held that a party is "free to adopt a 'no pay' position"¹ at a mediation, the U.S. Bankruptcy Court for the Southern District of New York issued a memorandum decision holding the secured lender and its counsel in contempt for failing to mediate in good faith and imposing sanctions upon them. The discussion below highlights the Southern District of New York's decision reversing the bankruptcy court decision and establishing a clear standard for determining a party's good faith participation in a court-ordered mediation.

What Constitutes Good Faith Participation in a Court-Ordered Mediation?

On March 18, 2011, the United States Southern District of New York issued its decision reversing the bankruptcy court's order. As an initial matter, the district court noted that while mediation is typically a voluntary process, a mandatory court-ordered mediation forces adversary parties to participate in a process that neither of the parties may desire. As a result, many courts have adopted or proposed a requirement of good faith, but have failed to develop any clear standards for evaluating good faith in a mandatory court-ordered mediation.

In seeking to establish a standard for good faith participation in a court-ordered mediation, the district court was guided by "considerations of litigant autonomy and confidentiality in mediation proceedings."² The district court referenced case law supporting the view that a court cannot coerce a party into making an offer to settle³ and in fact, recognized that the lender was within its rights to "predetermine[] that it was not liable" and to "insist[] on being dissuaded of the supremacy of its legal position."⁴ As the court noted, despite the bankruptcy judge's "good faith" intention in ordering mediation, "certain disputes are simply not amenable to mediation" and it should not be surprising "when attempts to mediate them quickly deteriorate."⁵ Further, the district court dismissed the bankruptcy court's view that the standard for determining participation is "risk analysis" because it is often an "internal process" that is "difficult — if not impossible" to determine the extent of any such analysis.

In holding the evidentiary hearing, the bankruptcy court was forced to determine facts relevant to participation while attempting to shield itself from the confidential aspects of the mediation.

Additionally, the district court recognized that inquiring into parties' "good faith participation" compromises the fundamental tenet of confidentiality in mediation. Confidentiality is a critical element of successful mediation as it assures that discussions cannot and will not be disclosed by the mediator in order to induce the parties to speak openly. In holding the evidentiary hearing, the bankruptcy court was forced to determine facts relevant to participation while attempting to shield itself from the confidential aspects of the mediation. Ultimately, confidential information was communicated to the bankruptcy court, which prompted the district court to explicitly hold that "confidentiality considerations preclude a court from inquiring into the level of a party's participation in mandatory court-ordered mediation."⁶

The district court continued by defining a party's good faith participation as "the extent to which a party discusses the issues, listens to opposing viewpoints and analyzes its liability," noting that this definition provides a "clear and objective standard with minimal intrusion into confidentiality and a party's right to refuse to settle."⁷ However, the district court did go on to note that where a party "demonstrates dishonesty, intent to defraud or some other improper purpose, the benefits of inquiry into such conduct may outweigh considerations of coercion and confidentiality."⁸ Such was not the case here, and, accordingly, the district court found that the bankruptcy court's determination that the lender did not participate in good faith was clearly erroneous.

Furthermore, the bankruptcy court's decision that the lender's representative did not have settlement authority was also reversed by the district court on the clearly erroneous standard. As articulated by the district court, the bankruptcy court "applied an unworkable and overly stringent standard for determining 'settlement authority' and accordingly, abused its discretion" in requiring the representative to have settlement authority to settle the case for an amount greater than the amount in controversy and to be able to enter into undefined "creative solutions." The district court established a standard for "settlement authority" in stating that the requirement is satisfied "by sending a person with authority to settle for the anticipated amount in controversy and who is prepared to negotiate all issues that can be reasonably expected to arise."

Finally, concerning the procedural aspects of the mediation, the district court noted that the pre-mediation exchanges were valid points of concern and the mediation order did not prevent the lender from raising such concerns. Thus, the district court held that the bankruptcy court was clearly erroneous in finding that the lender's pre-mediation procedural inquiries violated the mediation order and reversed the bankruptcy court's contempt order as an abuse of discretion.

Implications of Decision

The bankruptcy court's decision created a grave risk of undermining the core values of mediation and establishing a vague and otherwise inoperable standard of "risk analysis." The bankruptcy court decision would have empowered mediators to threaten parties with allegations of bad faith mediation if they refused to settle. In reversing the bankruptcy court's decision, the district court confirmed a party's right to adopt a "no pay" position at a mediation and fully affirmed the position taken by the lender both prior to and during the mediation.

The Southern District Court's decision establishes a clear standard for determining a party's good faith participation in a court-ordered mediation. Guided by considerations of litigant autonomy and confidentiality, the district court established that so long as a

party 1.) discusses the issues; 2.) listens to opposing viewpoints; and 3.) analyzes its liability, a party satisfies its requirement to participate in good faith. This decision also establishes a standard for determining "settlement authority" in a court-ordered mediation.

Confidentiality is a critical element of successful mediation as it assures that discussions cannot and will not be disclosed by the mediator in order to induce the parties to speak openly.

The district court's clarification of a "no pay" position establishes that such a position is not sanctionable conduct. To require any other standard would defeat the purposes of court-ordered mediation — reducing docket congestion, aiding effective judicial administration and promoting productive negotiations. The district court's decision ensures that these objectives remain intact, while also providing guidance for future parties' conduct at a court-ordered mediation. [abfj](#)

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ENDNOTES

- 1 *Negron v. Woodhull Hosp.*, 173 Fed. Appx. 77 (2d Cir. 2006).
- 2 *A.T. Reynolds & Sons, Inc.*, 2011 WL 1044566 at *7.
- 3 See *Kothe*, 771 F.2d at 669 (2d Cir. 1985); *Bulkmatic*, 2002 WL 975625 at *2.
- 4 *A.T. Reynolds & Sons, Inc.*, 2011 WL 1044566 at *7 (quoting bankruptcy court decision).
- 5 *Id.*
- 6 *Id.* at 8. It is noteworthy that while the Eastern District Bankruptcy Court adopted substantially the same rules as contained in M-117, E.D.N.Y. Local Bankruptcy Rule 9019(e) provides: "If a mediation participant willfully fails to participate in good faith in the mediation process, then the mediator shall submit to the clerk and serve on the mediation participants a report of the failure to participate. The report shall not be electronically filed, shall state on the first page at the top right corner that it is *being submitted to the attention of the clerk*, and shall state that it is a report of a failure to mediate in good faith that should not be filed or given to the judge. The report shall not be sent to the judge presiding over the matter. The clerk shall deliver the report to the judge designated by the chief judge for mediation, who will take appropriate action, including holding a conference or hearing in person or telephone, and who may, in appropriate circumstances, impose sanctions." Thus, in the Eastern District, the judge hearing the claims of bad faith mediation is a judge other than the judge sitting over the general proceedings of the case.
- 7 *Id.*
- 8 *Id.*