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Remedies for Refusing to Consummate a Settlement Agreement Reached at Mediation

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Raising an allegation that a party has not participated in the mediation process in good faith has historically been a sensitive hot-button issue for mediators, parties, and even the courts. In fact, even on occasions where the charge is made and the question has been posed to a court, courts have generally been reluctant to find bad faith at a mediation unless there is some clear objective line that one of the parties crossed, such as a failure to appear, failure to have a party representative with knowledge or authority attend, or a failure to provide a mediation statement. Courts regularly make clear that while mediation may be mandatory, settling at a mediation is not. However, what if parties have reached some form of agreement at mediation, then refuse to move forward to consummate the same? Is that also bad faith? What will courts do in such a scenario?

At the outset, let's consider the leading example of a court's reluctance to find bad faith (or a lack of good faith) in *In re A.T. Reynolds & Sons Inc*.[1] In that case, the mediator "submitted a report to the bankruptcy court detailing the allegations of bad faith," including 11 specific allegations concerning one of the parties.[2] Those allegations included certain actions of the party: (1) objecting to the topics to be covered in mediation; (2) demanding to know the identities of who would attend the mediation; (3) suggesting the mediation would be a waste of everybody's time; (4) sending a junior representative and junior counsel; (5) attending mediation without an open mind or willingness to compromise; (6) being unwilling to listen at mediation; (7) threatening to never use the mediator's services again if he reported any bad faith, and (8) refusing to make a settlement offer until after a bad-faith hearing in court.[3]

Based on those details and the evidence presented at a hearing, the bankruptcy court found that the offending party's "dilatory and obstructive behavior" was evidence of a "fail[ure] to participate in the mediation in good faith."[4] The bankruptcy court held that such failure amounted to contempt of court and issued sanctions requiring the offending party to "bear the costs of the Mediation, including the costs of the Mediator and the other Mediation Parties to attend."[5]

Upon appeal, the U.S. District Court for the Southern District of New York reversed the bankruptcy court's sanctions and contempt orders, finding that the sanctions order was an abuse of discretion and the contempt order was unjustified.[6] The crux of the district court's decision was that the alleged offending party complied with all objective requirements of the applicable mediation order and that a failure to settle did not equate to a lack of good faith, as the party "was within its rights to enter the mediation with the position that it would not make a settlement offer."[7] The district court also expressed significant concern with "[i]nquiring into the parties' level of participation" at the mediation, as such inquiry could "imperil ... the confidentiality of mediation."[8]

More recently, Hon. **Gregory L. Taddonio** of the U.S. Bankruptcy Court for the Western District of Pennsylvania addressed a question of whether a party's refusal to consummate an agreement constituted bad faith in *In re Jones*.[9] The mediation at issue in *Jones* concerned an action by the chapter 7 trustee to avoid the transfer of the debtor's sole interest in his house to himself and his wife as tenants by the entirety. After the court ordered mediation at the defendant's request, mediation took place and ended with the mediator filing a certification of completion "verifying that the Defendants reached an agreement with the trustee."[10]

After a settlement stipulation had not been filed, the court entered an order to show cause. In their response, the debtor and his wife "admitted [that] they reached an agreement with the trustee, but they did not want their attorney to memorialize it."[11] The court determined that mediation was unsuccessful but held a hearing to determine whether the parties

1 452 B.R. 374 (S.D.N.Y. 2011).
2 *Id.* at 379.
3 *See In re A.T. Reynolds & Sons Inc.*, 424 B.R. 76, 80 (Bankr. S.D.N.Y. 2010).
4 *Id.* at 95.
5 *Id.*
6 *In re A.T. Reynolds*, 452 B.R. at 385.
7 *Id.* at 382.
8 *Id.* at 383.
9 2021 WL 3148959 (Bankr. W.D. Pa. July 26, 2021).
10 *Id.* at *2.
11 *Id.*

failed to "make a good-faith effort" to reach a settlement.[12] The court explained that while "sanctions issued under a Court's inherent authority usually need a determination of bad faith, evaluating good faith under Rule 16(f) does not require such an affirmative finding."[13] Judge Taddonio explained as follows:

> Mediating parties must act in good faith. The question here is whether the Defendants ... did so. In general, they demanded and engaged in mediation with the chapter 7 trustee but, after an agreement was reached, declined to memorialize it. Instead, the Defendants tried to re-negotiate the settlement before ultimately abandoning it [altogether].[14]

In imposing sanctions,[15] the court held that the defendant's actions "were not substantially justified and display a lack of good faith," therefore sanctions were necessary to "reimburse the trustee for this wasted effort."[16] In particular, the court held that the defendants' actions "delayed the adjudication of this adversary proceeding and multiplied the number of hearings [that] the trustee had to attend and responses [that] he was required to file, unnecessarily squandering the resources of the Court and this estate."[17]

While Judge Taddonio ordered sanctions relating to conduct at mediation relating to a settlement, he made it clear that he did not disagree with one of the fundamental holdings of *A.T. Reynolds*: "To be clear, the Court is not sanctioning the Defendants for a failure to come to an agreement. Rather, their refusal to memorialize the agreement they actually reached along with their pre- and post-mediation conduct informs the Court's decision."[18]

Alternatives to Finding Bad Faith?

In *Jones*, "[r]ather than enforce an agreement that was never defined, the Court determined that mediation was essentially unsuccessful."[19] By not enforcing the settlement, the litigation continued, requiring the court to rule on the trustee's motion for summary judgment. Are there alternatives for courts to consider as opposed to rendering a finding of bad faith? In *Shinhan Bank v. Lehman Brothers Holdings Inc.*, the bankruptcy court, district court and court of appeals explored the alternative approach: enforcing the settlement reached at mediation.

In *Shinhan Bank v. Lehman Brothers Holdings Inc.*, the parties were referred to mediation while a motion to dismiss was pending. The parties had a settlement conference with a mediator in which a mediation proposal was made. Counsel for Shinhan wrote to the mediator 14 days later: "We appreciate your consideration in allowing Shinhan Bank additional time to consider your settlement proposal in this matter, which we are pleased to report that Shinhan has agreed to accept. We look forward to hearing back from you once you have Lehman's response."[20]

That same day, the mediator sent an email to both sides confirming the settlement terms. The next day, counsel for Lehman circulated a draft settlement agreement, to which Shinhan's counsel only provided nonsubstantive comments. In the meantime, oral arguments on the motion to dismiss took place. Shinhan's comments were accepted, and an execution version, signed by Lehman, was circulated. The case then took a turn on June 28. That morning, in response to Lehman counsel asking Shinhan counsel for an update on receiving a fully executed settlement agreement, Shinhan's counsel responded, "Shinhan just confirmed that they have completed their internal approval process and the Settlement Agreement will be signed by Thursday, June 30 ... after which they will remit the Settlement Amount."[21]

Four hours later, the bankruptcy court granted the motion to dismiss and entered an "order dismissing Lehman's claims against Shinhan and other defendants in the adversary proceeding, with prejudice."[22] The dismissal apparently changed Shinhan's view on the settlement agreement, as its counsel then informed Lehman's counsel "that it did not believe an enforceable settlement agreement had been entered into and that it would not pay the Settlement Amount."[23]

Rather than raising bad faith, Lehman filed a motion to enforce the settlement reached at mediation, a motion that was granted by the bankruptcy court. In affirming that decision, the district court noted:

> Allowing Shinhan to back out of the April 20 agreement because the parties took steps to record their agreement in a writing would frustrate the important goal of committing to writing already-agreed-to settlements.[24]

The district court was then affirmed by the Second Circuit, even though the circuit noted that it was "a close case."[25] Like the district court, the Second Circuit noted:

> Indeed, Shinhan's counsel [had] assured [Lehman Brothers Holdings Inc.'s] counsel that the settlement agreement would be signed, and it was only after [Lehman Brothers Holdings Inc.'s] adversary proceeding against Shinhan was dismissed that Shinhan reneged on its agreement.[26]

The Second Circuit did make note of "Shinhan's counsel's experience settling cases in the Lehman bankruptcy" as being relevant to whether the parties had in fact "agreed to all of the material terms of the agreement on April 20 [when the mediator confirmed the settlement]."[27]

Conclusion

It should be beyond cavil that even in cases where mediation is mandatory, as opposed to cases where the parties voluntarily opted into mediation on their own, settlements are not mandatory. In fact, mediating parties do not even have to make a settlement offer. However, if the parties make offers and reach a settlement, they are expected to carry through with any agreement they reach. In the event they do not, both the *Jones* and *Lehman* cases provide two avenues that aggrieved parties may take to seek redress. abi

12 *Id.* at *3.
13 *Id.*
14 *Id.* at *1.
15 As of January 2022, the amount of sanctions had not yet been finally determined.
16 *Id.* at *5.
17 *Id.*
18 *Id.*
19 *Id.* at *3.
20 *Shinhan Bank v. Lehman Brothers Holdings Inc. (In re Lehman Brothers Holdings Inc.)*, 2017 WL 3278933, at *1 (S.D.N.Y. Aug. 2, 2017).
21 *Id.* at *2.
22 *Id.*
23 *Id.*
24 *Id.* at *4.
25 *In re Lehman Brothers Holdings Inc.*, 739 Fed. App'x 55, 59 (2d Cir. 2018).
26 *Id.* at 58.
27 *Id.*