Mediation Can Save Time And Money—And Enhance Outcomes

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I. INTRODUCTION

Although I am a former litigator in the Bank of America Tax Department, I first learned the value of mediation while working for the Motion Picture Association of America, Inc.—the trade association for the major Hollywood studios. It quickly became apparent that a consensus position amongst competitors could be used to *promote mutual interests* in negotiations with governments. The challenge was to forge a consensus position, and the rewards were more than worthwhile to all concerned. Mediation became the logical "next step" in my career path.

I now conduct a private mediation practice as a neutral in Los Angeles, and serve as a volunteer neutral in mediations for the state and federal courts—hence, the focus in this article on the local court rules. I have asked Debra Estrem to join me as co-author by sharing her views on mediation as a practitioner representing taxpayers in federal tax disputes. Our goal is to create an awareness of the *benefits of mediation in appropriate tax cases and provide a resource for accessing it.*

II. WHAT IS MEDIATION?

Alternative dispute resolution or "ADR" is the term assigned to any means of settling disputes outside of the courtroom. ADR typically includes arbitration (binding and non-binding), direct negotiation/settlement, mediation, and early neutral evaluation.[2] The two most common forms of ADR are arbitration, where a neutral panel of one or more arbitrators makes a decision on the merits of a case, and mediation, where a neutral third party facilitates the resolution process. Some parties like to combine the two ADR processes with an agreement that mediation will be used first and if no resolution is reached the matter will be arbitrated.

Mediation is "a process in which a neutral person or persons *facilitate communication* between the disputants to assist them in reaching a mutually acceptable agreement."[3] A "neutral" or mediator is an objective person who can provide a "reality check" and assist the parties to find a mutually satisfactory resolution. Unlike an arbitrator or a judge, a mediator is not a third party decision-maker.

The mediation process is similar to a settlement conference with important differences. Both mediation and settlement conferences aim to reach a mutually agreeable resolution to some or all issues in dispute. The main difference between the two is that mediation uses a third party "neutral" and is based on the legislative mandate of *voluntary participation and self-determination.*[4] Settlement conferences are generally conducted by a judge and can be judicially compelled. The special confidentiality requirements for mediations do not apply to mandatory settlement conferences.[5] Both mediation and settlement conferences may use an evaluative approach to assess litigation strengths and weaknesses, but judges tend to be directive rather than facilitative in pursuing resolution.

III. ADVANTAGES OF MEDIATION

Mediation can save time and money and provide a confidential forum, a flexible process, and an outcome controlled by the parties. Because mediation does not require significant court resources, it can be used to *expedite conflict resolution* and reduce the court's backlog from an ever-growing caseload. The parties can agree to mediation at any point in their dispute resolution process, potentially *saving the expense of trial preparation and litigation.*

Mediation offers a way to deal with tax disputes in private, where sensitive financial information is often at issue. *Litigation is public.* Court records can be sealed by court order but are otherwise public documents.[6] Likewise, court proceedings such as motions and trials are generally open to the public. Specific statutes and court rules ensure that *mediation proceedings remain confidential.*[7]

In mediation, the *parties control the process and their own outcomes.* The parties can choose the neutral, the date for hearing, the time to be spent at mediation, and the approach they want to use. Mediation allows for a broader view of the dispute to reach *resolution of issues outside the court's jurisdiction,* such as misperceptions and misunderstandings between the parties. Resolution of these issues can be especially important in tax cases where there is an ongoing relationship. The parties may include provisions in their settlement agreements that go beyond what a court is authorized to order.

IV. THE MEDIATION PROCESS: HOW IT WORKS

There are *two primary approaches* to mediation: evaluative and facilitative. The facilitative approach promotes communication and negotiation between the parties. The evaluative

approach provides a "reality check" regarding the legal and evidentiary merits of the case. Mediators often combine these approaches in a continuum. The parties should consider selecting a mediator experienced in the approach they prefer. If the parties want to use an *evaluative approach,* they will want a mediator with a tax background and litigation experience with government agencies. If the parties prefer a *facilitative approach,* they will want a mediator with consensus-building, communication and "people" skills. In all cases, the parties will want a mediator in whom they have trust and confidence.

There is *no restriction on "ex parte" contact* with the mediator. Many mediators will schedule a joint pre-mediation teleconference to address the logistics, e.g., scheduling, participants, time, place, special needs, etc. Some mediators will also hold one-on-one pre-mediation teleconferences to discuss issues raised in the briefs and potential obstacles to settlement. Counsel should take advantage of the rules regarding confidentiality and ex parte contact to be candid about the strengths and weaknesses in the case, as well as any client control issues. Most mediators will ask you what information is for their use only and cannot be shared with the other party. Don't forget to *alert the mediator to what is confidential.*

Most mediators require *briefs* in advance of the mediation. The brief serves several functions. It can be used to narrow the issues—both substantive and procedural, and as an opportunity to "make your case" directly to the other party. Attaching evidence and controlling authorities may be very effective in establishing the strength of your case. If the parties are to exchange briefs, they can submit confidential matter to the mediator in a separate brief. In some cases, the parties instruct the mediator that their brief is strictly confidential and no portion of it is to be shared with the other party.

Even if the case does not settle at the mediation session, counsel can identify undisputed issues to provide the basis for a stipulation of facts. If substantial discovery remains outstanding at the time of mediation, the parties may be able to reach agreement on a discovery schedule.

The mediation session often starts with a *"joint session"* in which all parties and their counsel meet together in one room. After the mediator's introduction, generally counsel for plaintiff will start with an opening statement, followed by counsel for the defendant. There are several reasons to use a joint session. For the taxing agency, its representative can add a human dimension to the agency. For taxpayer's counsel, the joint session provides an opportunity to "showcase their talents" for their clients, to assess the witness potential of the opposing party, to speak directly to the other party without having their words interpreted by the other side's lawyer, and to watch opposing counsel "in action." However, when dealing with antagonistic parties or counsel, a joint session may further polarize them. In those cases, it may be best to dispense with the joint session and go directly into separate caucuses or a joint session of counsel without clients.

"Separate caucuses" are held between one party, counsel and the mediator. They enable the mediator to listen to each side without interruption, and to recommend how best to communicate with the other side. More importantly, given the confidentiality provisions discussed above, separate caucuses give counsel an opportunity to candidly discuss the likely outcome at trial. In cases with "client control" issues, it may make sense to request a separate caucus with only the mediator and counsel present.

Mediators often ask the parties to identify their *BATNA,* which is an acronym for the "*best alternative to a negotiated agreement."* In other words, what is the best outcome you can hope to achieve in trial. It is important to remember that the BATNA must be compared to the certainty, immediacy, economy, privacy and control of reaching an agreement at the mediation session. Each party should also consider his or her worst case scenario, e.g., the financial, emotional and logistical cost of losing in litigation, the realistic odds of winning, the likely outcome, etc.

Most counsel are comfortable allowing their clients to have an active role during the separate caucuses; some counsel find active *client participation* to be valuable in the joint sessions, as well. Participation by the clients allows them to feel "heard." Frequently, clients make valuable contributions to the resolution process. Give some thought to the various options, prepare your client in advance, and *let the mediator know which approach will work best for you.*

V. FEDERAL TAX CASES: HOW TO ACCESS MEDIATION

A. Administrative Proceedings

Because of the sheer size and quantity of disputes facing the *Internal Revenue Service,* the agency has long relied on alternative dispute resolution, including mediation, to keep its huge caseload under control. This caseload also motivates the IRS to experiment with new programs that will resolve disputes earlier in the Examination process. Many of these programs have been highly successful.

For decades the *IRS Office of Appeals* has successfully served as an internal "fresh look" at disputes between taxpayers and IRS examiners. The Office of Appeals is the bread and butter of federal tax issue resolution, with a settlement rate typically upwards of 85 to 90 percent. Although it is strictly an internal function, introducing a new and different IRS specialist to look at disputes with an eye toward settlement facilitates resolution. In 1998, the ex-parte rules served

to make Appeals hearings even more neutral[8] by restricting ex-parte communications (communications without the taxpayer or their representative present) between Appeals Officers and other IRS employees about a shared case.

Outside mediation generally is not available until after the Appeals process is finished, but various resolution options are available internally, beginning as soon as an examiner adequately develops a particular issue. One of the most successful internal mediation and settlement programs is *Fast Track,* which was first launched as a pilot in 2001 and has since been expanded to include broader categories of cases,[9] including tax exempt bonds.[10]

The Fast Track program uses specially trained IRS Appeals Officers to help facilitate resolution of unagreed issues while the case is still under Examination jurisdiction. The procedure is optional and voluntary, both the government and the taxpayer must agree that it is appropriate, the results are non-precedential and confidential, and the time frame is relatively short (ideally within 30 to 40 days for small business/self employed cases and 120 days for large and midsized business cases). Fast Track cannot take place until after the thirty-day letter is issued[11] because the case then leaves Examination jurisdiction. The negotiations, in the author's practice experience, are usually very intense and require a lot of up-front preparation. Both parties are required to have a decision-maker present for on-the-spot resolution. The actual negotiation usually lasts one full day, but can extend longer. Either party can withdraw at any time. The success rate is very high.

At the close of a successful Fast Track session, the parties typically execute a session report setting forth the terms of the agreement. The case can then be closed either using normal Examination procedures or Appeals procedures (for example, Form 870-AD or Form 906-Closing Agreement).

There are times when Fast Track is not the best option. It is important to have a functional relationship with the Examination team, as Fast Track is a direct, face-to-face negotiation with Examination and ex-parte must be waived. Another barrier is that examiners are often hesitant to use Fast Track because it requires them to keep jurisdiction of the case and continue working on it longer than they otherwise might have. Sometimes it is necessary to go up the management chain in order to receive approval for Fast Track and even then there is no guarantee.

Whether for reasons of confidentiality, expense, the perceived need for specialized tax expertise, or because the internal dispute resolution process functions reasonably well, no formal mediation or dispute resolution programs that contemplate using an outside mediator are available until after the Appeals process is finished. The *Post-Appeals Mediation* program[12] is generally the first time the parties are able to bring in an outside mediator, if desired. The procedures also allow for an internal Appeals mediator, if desired. Based on the author's practice experience, however, it is often preferable for the parties to incur the cost of jointly hiring an outside mediator. By the time a dispute has reached this late stage, a true outside perspective can often help the parties find middle ground and successfully resolve an issue that would otherwise be headed for the courtroom.

B. Judicial Proceedings

If the matter cannot be resolved in Appeals or Post-Appeals Mediation, typically a statutory notice of deficiency is issued and the litigation stage of the case begins. A popular option is to petition the *United States Tax Court,* a federal court whose judges travel around the country to designated cities to conduct trials concerning disputed tax matters. Tax Court is the only judicial forum that allows taxpayers to contest a tax liability without paying all or part of the liability first. If taxpayers are willing to pay first, they can sue for a refund in either *United States District Court* or *United States Court of Federal Claims.*

Mediation in the *Tax Court* is relatively rare. The Tax Court Rules do not reference mediation, although Rule 124 specifically permits arbitration. *The Internal Revenue Manual,* however, does discuss Tax Court mediation at length[13] and provides a model agreement to mediate and model mediation participants list.[14] It is the author's belief that an increased emphasis on mediation once a case is within jurisdiction of the Tax Court would benefit all parties. The benefits to the taxpayer and the IRS generally result in a more time efficient resolution of the dispute and significantly less expenditure of resources. For example, by not having to prepare and review formal trial briefs, taxpayers would have the distinct advantage of a confidential resolution, as opposed to a public trial and potentially published trial briefs and opinions. Lastly, the Tax Court would benefit from a reduced case load.

Mediation is particularly useful for *factual disputes,* including valuation.[15] High profile issues such as industry-wide issues, Appeals coordinated issues and cases designated for litigation by the government are generally not suitable for mediation.

In Tax Court, the mediation should take place *as soon as possible* after the case is docketed. This will allow sufficient time for discovery and trial should the mediation not fully resolve the case. The Tax Court will not necessarily grant a Motion to Continue to allow for mediation. For this reason, it is worthwhile for both parties to a newly docketed Tax Court case to consider at the outset whether mediation might be a viable option. If so, the parties should file a *Joint Agreement to Mediate* with the Tax Court as quickly as possible and immediately work to locate an appropriate mediator.

It is possible that the Tax Court may be willing to use one of its special trial judges to function as a mediator. For certain issues, it will be helpful to have a mediator with a tax background, but this is not always essential. For valuation or other purely factual issues, a non-tax mediator may be able to offer a fresh perspective that will help bring the parties to common ground. As suggested by at least one commentator, however,[16] it is wise to seek a mediator experienced in negotiating with the government in general, as there are unique motivators and constraints faced by government attorneys that are likely to come into play in any negotiation with them.

The *United States District Courts* offer mediation in their ADR programs.[17] The *Federal District Court for the Central District* offers mediation through its ADR Pilot Program.[18] The Court qualifies neutrals for service on the Attorney Settlement Officer Panel, listing them alphabetically and by area of expertise with a personal profile for each officer.[19] Attorney Settlement Officers provide *three hours of mediation time at no cost.* Cases subject to mandatory referral include those where the prayer for relief is $250,000 or less and an enumerated list of civil actions. While tax refund cases are not on the list of civil actions, the assigned judge has discretion to refer cases to the ADR Pilot Program. The *United States Court of Federal Claims* also has an ADR program, first adopted in 1987.[20] This program uses ADR Judges rather than third party neutrals.

In summary, mediation is readily available for federal tax disputes and, considering the ever-increasing cost of litigation and judicial appeal, parties would be well advised to consider it.

VI. STATE TAX CASES: HOW TO ACCESS MEDIATION

A. Administrative Proceedings

Like the Internal Revenue Service, the California *Franchise Tax Board* (FTB) has a settlement program available to resolve disputes at the administrative level. This program was first launched in 1992, and became permanent in 1994.[21] The program does not use a third party neutral, but provides an opportunity for direct negotiation between the taxpayer (with or without his or her adviser) and a representative from the FTB's Settlement Bureau. All participants are required to sign a non-disclosure agreement to promote candor and ensure confidentiality.

The Settlement Bureau program has been incredibly successful. It has been used in thousands of cases, with a success rate of 75%. Acceptance into the program is discretionary, but includes a broad range of cases with no minimum or maximum amount in controversy. More than 200 cases are submitted a year, with a 90% acceptance rate. Resolution of cases submitted to the Settlement Bureau occurs within nine months. There is an expedited approval process for cases where the reduction in tax and penalties is less than $8,800.

Mediation with a third party neutral is available in multistate tax cases through the *Multistate Tax Commission's* (MTC) ADR program. The types of cases best suited to this ADR program are those involving two or more states attributing the same income or the same sales transaction to more than one state for apportionment or other tax purposes, or where two states are treating the same source of income differently resulting in duplicative taxation. Likewise, in the transactional area, two or more states may view the same transaction as being subject to taxation under their respective sales and use tax laws, creating multiple taxation of the same transaction. Both mediation and arbitration are available through the MTC ADR program.[22] The ABA Section of Taxation Newsquarterly recently reported an MTC mediation success story.[23]

B. Judicial Proceedings

If you are not successful in resolving your state tax dispute at the administrative level and are forced to file a refund suit in the Superior Court, you have another opportunity to access ADR. Historically, the government agencies involved in litigating state tax cases were slow to accept mediation. However, in the last 5 years or so, the Attorney General's Office, Tax Division, as well as the Franchise Tax Board have accepted and even welcomed its use in appropriate cases. City Attorneys also use mediation to resolve local tax disputes. When a government entity requires settlement approval by an elected official or legislative body, a representative with authority to recommend such an agreement is required to attend the mediation. [24]

Because Los Angeles is the largest county in the state[25] and has offered ADR processes since the mid-1970s, it will be used to highlight ADR procedures in the California courts. (References to other counties' local rules can be found in the endnotes.)[26]

The Los Angeles Superior Court (LASC) first offered mediation services in 1995, and it quickly became the most utilized method of ADR. The LASC has jurisdiction at the trial court level for three categories of civil cases: small claims (involving claims for relief of $7,500 or less for individuals and $5,000 or less for corporations or other entities), limited jurisdiction (involving claims for relief of $25,000 or less), and general or unlimited jurisdiction cases (involving claims for relief in excess of $25,000). The rules for accessing ADR vary depending upon the category of case involved.[27] This discussion will focus on general jurisdiction cases.

The first formal *opportunity for parties to choose mediation* in general jurisdiction cases occurs at the Case Management Conference, which the court schedules within 180 days after a complaint is filed.[28] Typically, the parties have not completed their formal discovery at this juncture, so it may be difficult to utilize mediation unless the facts have been fully developed during the underlying administrative proceedings.

The court may also refer a case to mediation at the pre-trial conference. At this point, it is likely that the parties have completed discovery and incurred substantial costs. Alternatively, the parties can stipulate to court-connected mediation prior to the Case Management Conference.[29]

Once mediation is selected, the court will issue an order with a completion date.[30] The completion date can generally be extended by court order, upon stipulation of the parties. The parties may then choose a neutral from one of the court's panels, or notify the court of their decision to use a non-panel member. The parties can select a neutral by name or expertise using the ADR website or ask the ADR staff to randomly assign a neutral from either the Pro Bono or Party Pay Panel.[31]

In the LASC, neutrals on the Pro Bono Panel[32] provide *3 hours of hearing time at no cost.* The Party Pay Panel mediators have more experience with court-connected mediation, and have agreed to accept $150 an hour (collectively) for 3 hours of hearing time.[33] California Rules of Court govern the standards of conduct for mediation neutrals.[34]

If the parties access the Pro Bono Panel or Party Pay Panel without full resolution of the issues, the parties may retain a mediator privately. Likewise, if the parties choose to continue beyond the 3 hours of free or reduced rate mediation, they may agree to retain the neutral at his or her regular rate.[35] In general, the parties share the fees for mediation neutrals, ranging from $200 to $1,000 an hour, equally.

VII. CONCLUSION

We believe that mediation can be a *cost-effective* alternative to traditional dispute resolution processes in both state and federal tax cases that are *fact intensive.* It may be of limited value in cases involving constitutional challenges, statutory interpretation, or those where the result is likely to have significant precedential value.[36] Where a party asserts a constitutional challenge or statutory interpretation already addressed by the courts, however, a neutral may be able to highlight the futility of re-litigating the issue in the absence of new, sound arguments.

No hard and fast rules apply in the mediation arena, so it is well suited to accommodate the myriad variables presented by each unique person and each set of facts. The key to the success of mediation rests in its flexibility to expand the options for conflict resolution beyond the win-lose option of a trial**.** Counsel should use their mediation session to streamline the case in any way they can.

The Superior Court Pro Bono and Party Pay Panels and District Court Settlement Officer Panel provide counsel with a cost-effective alternative to the time and cost of a trial, while enhancing the possibility for a negotiated compromise. In addition, these panels provide counsel with an opportunity to evaluate the effectiveness of local mediators for future sessions or cases. You may find it beneficial to review your existing caseload to see if you have any cases ripe for mediation.

ENDNOTES

1. Barbara L. Rosenfeld Mediation and Consulting, http://www.Resolve-Disputes.com, Barbara@Resolve-Disputes.com, phone: 310–440–8200. Debra K. Estrem, Senior Manager, Tax Controversy Services, Deloitte Tax LLP, http://www.deloitte.com, destrem@deloitte.com, phone: 415–783–5945. This paper was principally authored by Barbara L. Rosenfeld. Debra K. Estrem contributed the section on IRS and U.S. Tax Court dispute resolution. The authors would like to thank Benjamin F. Miller, Director Multistate Bureau, FTB; Patrick J. Bittner, Director, Settlement Bureau, FTB; and Melissa Wulff, Tax Counsel III, FTB, for their time in sharing their views.

2. *See* ¶1:478, California Practice Guide, Civil Procedure Before Trial, The Rutter Group (2008).

3. California Rules of Court, Rules 3.800 and 3.852.

4. California Rules of Court, Rule 3.853.

5. California Rules of Court, Rule 3.1380.

6. California Rules of Court, Rules 2.550(c) and 2.551.

7. *See* California Evidence Code §§703.5, 1115–1128 and 1152; Code of Civil Procedure §§1775.10 and 1775.12; and California Rules of Court, Rule 3.854.

8. The IRS Restructuring and Reform Act of 1998, P.L. 105–206, Act §1001(a)(4) (July 22, 1998).

9. Notice 2001–67, 2001–2 C.B. 544; Revenue Procedures 2003–40 and 2003–41, I.R.B. 2003–25; Announcement 2006–61; IRS News Release IR-2007–200.

10. Fast Track is not yet formally available to tax exempt entities and estates and, considering its success, the Service should consider expanding it to these areas.

11. The 30-day letter is generally issued at the close of an unagreed examination and is the "ticket" to appeals.

12. Revenue Procedure 2004–44.

13. Internal Revenue Manual §§35.5.5.5 through 35.5.5.8.

14. Internal Revenue Manual, Exhibits 35.11.1–117 and 35.11.1–118.

15. Practitioners in the area have suggested the use of "neutral experts" in valuation cases to reduce the time and expense of preparation and trial using experts for both sides. The "neutral expert" concept may work best in the "co-mediation model" used in family law cases. The co-mediation model uses a trained mediator and a family counselor to address the family law and emotional issues together.

16. Article, The Tax Executive, Nov.-Dec. 1996, *Tax Court Mediation: A Case Study, by Michael I. Saltzman.*

17. *See* Civ.L.R. 16–15 for the Central District, Civ.L.R. 16–271 for the Eastern District, ADR L.R. 6–1, et seq. for the Northern District, and General Order 387 for the Southern District.

18. General Order 04–01 and General Order 07–01.

19. *Se*e the "ADR" page at http://www.cacd.uscourts.gov

20. General Order No. 44 at http://www.uscfc.uscourts.gov/node/1619. The Court of Federal Claims took an active role in promoting ADR in the late 1980s, and expanded its use in 2007 through the ADR Automatic Referral Program.

21. FTB Notice 2007–2 at http://www.ftb.ca.gov/law/notices/2007/2007_2.pdf contains helpful information on the Settlement Program, including the procedure for requesting settlement consideration.

22. MTC ADR Form 100 and MTC Bylaw 14 at http://www.mtc.gov/Resources.aspx?id=278

23. Vol. 27, No. 4, ABA Section of Taxation NEWSQUARTERLY, page 12.

24. California Rules of Court, Rule 3.874(a)(1) and Los Angeles Superior Court (LASC), Local Rule 12.15.

25. The Los Angeles Superior Court serves the 9.5 million people of Los Angeles County with approximately 430 appointed judges and 100 commissioners. It is divided into twelve geographic districts and includes over 48 courthouses from Pomona to Santa Monica and from Lancaster to Long Beach. Approximately 30,000 of the estimated 160,000 civil cases filed in LASC annually come through the LASC ADR department. *See generally* LASC Alternative Dispute Resolution (ADR), "Neutral Resource Manual," pages 2 and 7.

26. See Local Rule 12.12, et seq. in Sacramento County, Local Rule 2.3.7 in San Diego County, Local Rule 4 in San Francisco County, and http://www.courtinfo.ca.gov/programs/adr/tcadr.htm for ADR programs in other counties not listed.

27. LASC Local Rule 12.0; Code of Civil Procedure §§1775.3–1775.5.

28. LASC Local Rule 7.9(a), (b), (c) and (f), and California Rules of Court, Rules 3.720 to 3.730.

29. California Rules of Court, Rule 3.726 and LASC Local Rule 12.16.

30. LASC Local Rules 7.9(c) and 12.2.

31. Parties can use the Name Search or Random Search functions at: http://www.lasuperiorcourt.org/adr/UI/INDEX.ASPX

32. The LASC Court Executive Committee recently increased the minimum Pro Bono Mediation Panel training requirement from 25 to 40 hours, which must include 20 hours of core/classroom training and 20 hours of practical training.

33. *See* Civil ADR Information at http://www.lasuperiorcourt.org/adr/UI/INDEX.ASPX

34. California Rules of Court, Rule 3.850 et seq.

35. LASC Local Rule 7.12(k)(5).

36. The Franchise Tax Board Litigation Coordinator shared this view.