Countering the “Empty Pocket” Defense:
And Other Tips for Settling Commercial Cases in a Bad Economy

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A multi-million dollar judgment means nothing if your client cannot collect. Likewise, while you may have the facts, evidence and law necessary to demand a large settlement from your opponent, it is of little value if the other side does not have the wherewithal to satisfy that demand. As the adage goes: “I cannot give you what I do not have.” Few things can frustrate a meritorious lawsuit more than a defendant with empty pockets. And, as companies continue to adapt to a changing economy, the “empty pocket” defense is becoming more and more prevalent.

This article examines what steps attorneys can take to counter the “empty pocket” defense and how to best maximize settlements in a down economy.

Check the Pockets. Are They Really Empty?
If a defendant asserted waiver, estoppel or statute of limitations as a defense to your lawsuit, you would not take its word for it. You would investigate, research, conduct discovery and use all other resources at your disposal to test the merits of that defense. The “empty pocket” defense is no different. You will need to verify your opponent’s claim of insolvency. The best way to do this is to simply ask to see the financials. Even if the other side is not required to disclose their financial documents, they are often willing to share that information in order to resolve a lawsuit. If they will not give you the financials, you should try to obtain some financial information through discovery. Even if you get the financials, you will want to verify their accuracy. Ask a forensic accountant to perform a quick review for anomalies, obtain back up documentation, or talk to customers or vendors. You can also use public databases to perform asset and title searches, or, if all else fails, consider hiring a private investigator.

Are There Any Other Pockets?
If the primary target has empty pockets, there may be other pockets you can dig into to get paid, such as insurance coverage. If there are concerns about the defendant’s ability to pay, great care should be taken to draft the complaint so that it will trigger insurance coverage, even if that means omitting meritorious non-covered claims. If the goal is compensation, you do not want to give the carrier any potential coverage defenses. Moreover, even if
insurance is not an option, you may want to look at adding wealthy third parties under an agency, conspiracy, aiding and abetting or alter ego theory. And, even if the third-party's pockets are also empty, you may be able to trigger their insurance coverage. For example, officers and directors of an insolvent company may owe a fiduciary duty to the company's creditors. If you can allege that the officers and directors breached this duty, then you may be able to trigger the company's D&O insurance policy as a potential source of recovery.

**Calling the Bankruptcy Bluff.**

A staple strategy of the empty-pocket defendant is to threaten to file for bankruptcy. Often times, this is only a bluff. Most companies want to avoid a bankruptcy filing at all costs, and are not prepared to follow through on this “nuclear option.” Even if you believe the threat is real, is bankruptcy really all that bad? While you may only get pennies on the dollar, you will at least know that you are on a level playing field with the other unsecured creditors. The company may be able to increase the money available by recovering preferences or unwinding insider deals. You could even volunteer for the creditors' committee to exert greater influence over the final resolution. In addition, depending on the nature of the case, you may be able to show that your claims are not dischargeable due to fraud, willful injury or some other statutory exception. If the threat of bankruptcy is made, you should immediately consult with a bankruptcy specialist to assess your options.

**Manage Client Expectations.**

When a client is told in the initial consultation that they have a “million-dollar case,” they quite naturally get locked into that number. By creating an unrealistic expectation at the outset of the case, it becomes very difficult to get your client to change their point of reference. Therefore, it is important to create reasonable expectations from the outset of the case. In addition, settlements can become nearly impossible where the sunk costs exceed the defendant’s ability to pay. To avoid this situation, you need to assess early in the case the defendant’s financial health and litigate accordingly. You may need to file fewer motions, take fewer depositions, hire fewer experts, and do less legal research than you would do if an insurance company or Fortune 500 company would pay the resulting judgment.

**Be Creative in Structuring a Settlement.**

I am a firm believer that the best settlements in commercial cases involve a one-time lump sum payment, which immediately severs the relationship between the parties. Unfortunately, that is not always an option. You may need to consider structured settlements, where the defendant pays a little every month over an extended period. In these cases, you will need to be sure to have adequate security for the total amount and should probably insist upon a stipulated judgment in the event of default. You may also want to look at the potential for non-monetary options. For example, in a trade secret case, even if the other side has no money, they may agree to refrain from using confidential information or soliciting competing customers. Or, maybe the other side will agree to surrender or license intellectual property, assign claims against third parties or insurance companies, or give some other form of non-monetary consideration.

**Throwing In the Towel.**

Sometimes, no matter how hard you squeeze, you will never get blood out of a turnip. If the defendant is simply broke, no amount of diligence, creativity, investigation and prayer will get your client paid. As hard as it may be, the only smart move is give up and move on. Hopefully, you adhered to the above advice by managing client expectations, so when you discuss this option with your client, it will not be taken by surprise. Before throwing in the towel, however, remember that judgments are typically valid for many years. So, if the defendant’s insolvency may be temporary, it may be worth taking the matter to judgment with the hopes of potentially collecting in the future. And, as circumstances often change, if you throw in the towel, do it in a way that preserves your client’s right to sue in the future. Dismiss cases without prejudice. Get the other side to sign a tolling agreement. And, be sure you and your client preserve evidence in case the client decides to pursue the claims in the future.

At bottom, the defendant’s ability to pay is a critical consideration in settling cases, and often times, more important than the merits of the case. Success is judged by your ability to maximize settlements in these difficult, and unfortunately common, situations.

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