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$4.1B Arbitration Award For Wrongful Termination?

Law360, New York -- A $4.1 billion arbitration award in a single plaintiff California wrongful termination case may have employers rethinking their dispute resolution strategies, if not their willingness to even do business here in the Golden State.

After all, mandatory arbitration is supposed to temper the unpredictability of juries, especially in potentially emotional employment disputes.

If an employer can be tagged for $4.1 billion by a single employee in a JAMS arbitration presided over by a respected retired judge, then maybe those juries are looking pretty good after all.

Employers, don't jump ship quite yet. While the headline-grabbing award – which has recently been confirmed by the Los Angeles Superior Court and is now a judgment of the court – is certainly sensational and unprecedented, the backstory puts it all in perspective.

There are lessons to be learned here, but jettisoning those arbitration agreements is not one of them. (Nor is fleeing the State, for that matter.)

The iFreedom Employment Lawsuit

Employer iFreedom Communications is a tech company that provides communication services over the Internet and WiFi technology. It was sued in by the company's former chief marketing officer, Paul Thomas Chester, who felt he was wrongfully terminated after complaining about the size of his commission payment.

Chester enjoyed an executive compensation agreement with one especially fortuitous provision: Under his employment contract, if Chester were to be terminated without cause, he would be entitled to certain commissions "on an ongoing and permanent basis." The agreement apparently also contained an arbitration provision.

Chester filed suit, and like most conscientious employers, iFreedom moved to compel arbitration. The motion was successful, and off to arbitration they went. Together, iFreedom and Chester selected JAMS arbitrator and former superior court judge William F. McDonald to preside over the proceedings.

iFreedom's $4.1 Billion Mistakes

During the arbitration, iFreedom made some tactical decisions that will leave most practitioners scratching their heads. First, it refused to participate in discovery. In particular, it refused to produce any information concerning its finances, despite a specific order by the arbitrator to do so. Apparently, the meager $1,210 sanctions award was not incentive enough to convince iFreedom to comply.

Next, iFreedom's principal, Timothy Ringgenberg, decided to fire his defense counsel and go it alone. For reasons never explained, from the middle of the arbitration process onwards, Ringgenberg represented himself and his companies on his own.

(In California courts, as in the courts of other states, corporations cannot appear pro se and must be represented by counsel. This does not apply to contractual arbitrations. Had the rule been otherwise, this story would surely have had a different ending. In fact, it wouldn't have been a story at all.)

As if this were not enough, Ringgenberg went a few steps further. He not only refused to attend the arbitration hearing, but he wrote a letter to the arbitrator confirming he received notice of the hearing, but announcing his intention to nonetheless skip it altogether. Hence, he was a no-show, thereby turning the arbitration into, essentially, a default prove-up hearing.

The $4.1 Billion Award

Ringgenberg probably never considered what creative attorneys can do in an unopposed forum in front of a jurist who was clearly unsympathetic to the disrespectful employer. Big mistake (again).

The arbitrator sought to compensate Chester for his lost future earnings based on the promise in the executive compensation agreement to pay Chester commissions for life in the event Chester was terminated without cause. (Was there any doubt that the arbitrator found the termination to be without cause?)

However, because iFreedom refused to produce any financial data, there was a dearth of evidence available from which to estimate what those future commissions might be.

Enter the power of the adverse inference. Chester produced an iFreedom shareholder letter in which the company reported monthly revenue of $535,000. The arbitrator also looked at evidence that the company had achieved growth rates of 10 to 20 percent for a few months after Chester started with the company.

Having nothing else to go on, the arbitrator used adverse inferences to fill the evidentiary void created by iFreedom's refusal to produce financial data during discovery.

Essentially, the arbitrator assumed that these revenue and growth rates would continue, month after month, year after year, ad infinitum. Ten percent growth per month equates to 120 percent growth per year. It does not take too long for exponential growth like this to reach into the billions.

In fact, it only took seven years for Chester's anticipated future commissions to reach the billion dollar mark, even taking into consideration a 5 percent present value discount rate. (The arbitrator cut off future earnings at seven years, despite the employment agreement's promise to pay commissions in perpetuity.)

On top of this — because apparently a $1 billion compensatory award was not enough to teach iFreedom its lesson — the arbitrator decided punitive damages were also necessary.

Specifically, the arbitrator found that the defendants' "conversion of monetary sums and property belonging to plaintiff and defendants' obtaining work and services from plaintiff without paying him" was so malicious that it justified an award of punitive damages "to punish and make an example of defendants."

Judge McDonald accordingly tripled the actual damages and awarded $3 billion in punitive damages.

All in all, the award looked like this:

- Unpaid salary: $323,500

- Interest on salary: $61,335.60

- Failure to provide Chester with shares of stock: $1,700,000

- Interest on the value of the stock: $630,590

- Commission (5 percent of gross sales): $964,342,168.59

- Punitive Damages: $2,926,276,674.27

- Post-hearing/pre-award interest ($267,239.88/day): $51,310,056.91

- Post-award/prejudgment interest at 10 percent ($1,083,597.33/day): $151,703,626.20

- Post judgment interest at 10 percent ($1,125,159.97/day and counting)

- Attorney's fees: $633,450.00

- Assorted other odds and ends

- Total: $4.1 billion and counting (at over $1 million/day)

On May 29, 2009, Judge Teresa Sanchez-Gordon of the Los Angeles Superior Court confirmed the award, thereby turning it into a judgment of the court, capable of being enforced with the assistance of the state just like any other court judgment.

Surprisingly (or maybe not), Ringgenberg and iFreedom did not challenge the award or seek to overturn it. If the defendants had any chance of challenging the award (and the ability to challenge a contractual arbitration award is very limited in the first place), they forfeited it by their continued inaction. There is very little, if anything, Ringgenberg can do now to derail this freight train.

Lessons Learned!

Needless to say, this is an outlier of historic magnitude, made interesting by the sheer size of the award. But even outliers provide lessons. For instance (and in no particular order):

1) Arbitrations Are Real. Despite the occasional appearance of informality, arbitration hearings are just as important as court trials, and their awards are ultimately just as enforceable. Employers (and employees) need to take them seriously. At a minimum, show up.

2) Defend Yourself. As with an attorney who represents himself, an employer who represents itself also has a fool for a client. Here, Ringgenberg dug his own financial grave when he fired his attorneys, failed to participate in discovery and refused to participate in the arbitration hearing.

3) Take Discovery Seriously. Even in arbitration, discovery obligations must be taken seriously. Financial sanctions for abuse are one thing, but judges (and arbitrators) have other tools with which to punish parties who refuse to abide by their discovery obligations. This case is a striking example of the

formidable power of adverse inferences being used to fill the gaps in the evidence created by a party's refusal to participate in discovery.

4) Check Your Executive Compensation Agreements. iFreedom obviously felt the need to provide Chester some economic security in order to entice him to join the company. But did it really need to promise him commissions for life in the event Chester was fired without cause? Even though the judge limited the damages to seven years, one can see how those commission figures can add up over time. Employers may want to consider adding some upper limits on their executive compensation packages.

5) Consider Your Arbitration Appellate Rights. As noted above, most contractual arbitration awards can only be challenged on very limited grounds — mistake of fact or error in application of the law not being among them.

Absent some special contractual appellate process allowing for the review and reversal of errant arbitration awards, even $4.1 billion awards to a single wrongful termination plaintiff will be confirmed by the courts without a sideways glance.

Employers may want to consider adding into their employment arbitration agreements the right of the parties to challenge an award. There are plusses and minuses to such an additional layer of review, but worth considering nonetheless.

This is not to suggest that even with contractual appellate rights, the Chester award would have been reversed. Ringgenberg sealed his own fate when, among other things, he compelled arbitration in the first place, and then participated in the process, not only agreeing to the arbitrator, but sending him a letter announcing that the defendants would not attend the hearing. So much for any due process defense.

All in all, the Chester award may be a record for a single plaintiff wrongful termination lawsuit. Whether Chester will be able to do more than frame the judgment for his wall will depend on whether

iFreedom has an extra $4.1 billion in accessible assets hanging around. We can all guess the answer to that one ...

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