

MEDIATION IN CROSS BORDER INSOLVENCY PROCEDURES

The practitioner's resort of choice in disputes concerning insolvent undertakings

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Some definitions

We propose being entirely orthodox by starting with some definitions of mediation. Every reader will be familiar with what constitutes arbitration, litigation and negotiation in the context of dispute resolution. What will not be so clear is how these other methods of dispute resolution should be distinct from mediation.

The EC Directive 2008/52 of 21 May 2008 on certain aspects of mediation in civil and commercial matters (the Directive) defines mediation as:

“...a structured process, however named or referred to, whereby two or more parties to a dispute attempt by themselves, on a voluntary basis, to reach an agreement on a settlement of their dispute with the assistance of a mediator. This process may be initiated by the parties or suggested or ordered by a court or prescribed by the law of a Member State.”

We find the CEDR¹ definition much more exciting:

“Mediation is a flexible process conducted confidentially in which a neutral person actively assists parties in working towards a negotiated agreement of a dispute or difference, with the parties in *ultimate control* of the decision to settle and of the terms of resolution.”

We have highlighted what to us seem the really important words of “ultimate control”. This is because the very opposite of being in control is the experience of parties with arbitration or litigation. Here, the power sits very firmly with the consensual or court appointed neutral who is given full decision making authority. Throw in the Byzantine complexity of procedural rules governing court proceedings, interminable delay and

astronomic cost and most litigants are begging to turn off the life support machine.

The question naturally arises of how is it that so many managers of undertakings dealing with a dispute will typically opt for the most restrictive of resolution mechanisms and place things firmly in the hands of their lawyers?

Reasons of space allow us to suggest only one of many possible answers and where there are likely to be huge cultural variances from country to country. And it is this. Most managers, indeed most of us, deal with conflict or the threat of conflict badly. Typically it will trigger the “fight or flight” response which is hardwired in all of us. The fight response will reveal itself in aggressive behaviour and therefore consequent damage to communications and relationships. The flight response means being in a state of denial that a conflict exists and not addressing the issues. Persisting in either response will lead to crisis.

The nature of conflict

Here we must pause for a moment. A new concept has been introduced: “conflict”, which is not quite the same thing as a dispute. Crawley² defines conflict as “a manifestation of differences working against one another” which have “ingredients” (the differences that inherently exist between the people in conflict such as cultural and value differences, interests, beliefs and patterns of behaviour), “combinations and conditions” (their contact with one another and the structures in which they operate) and “the spark” (what happens when the differences clash).

De Bono³, characteristically, does not restrict his definition of conflict to a clash of interests, actions or directions but invents some new words to help with the process of conflict resolution. He uses the expressions “confliction” to denote “the process of setting up, promoting, encouraging or designing conflict” and “de-confliction” to denote the opposite, i.e. the effort required to evaporate or demolish conflict. Perhaps we mediators should re-badge as de-confliction experts? At any rate, de Bono believes that our methods for resolving conflicts and disputes are crude and primitive⁴.

Now one of the main objectives of mediation is to restore the communication and relationship equilibrium between the parties. Open and honest communication and a trust relationship underpin all commercial negotiations which are successful. Parties to negotiations

frequently get stuck, however. Trust is a fragile commodity and is easily broken. Negotiators become entrenched in fixed positions. Or negotiations become stale as the parties simply give up. Views narrow and creativity in solution finding evaporates.

Enter the mediator

The introduction of a mediator as third party neutral into this scenario brings with it transformational possibilities. Not being identified with the parties or their positions the mediator can:

- Bring a completely fresh approach to the issues.
- Act as a safe conduit for confidential communications, i.e. settlement options can be more easily explored without the parties having to make disclosure to each other and perceiving their position to have been weakened.
- Act as a reality test by challenging assumptions. This is particularly important when dealing with intransigent positions and unrealistic expectations.
- Restore honest and open communication and the relationship equilibrium. The mediator will from the outset seek to develop trust and rapport between herself and the parties and ideally between the parties themselves. Whilst the ultimate goal is settlement of the dispute between the parties (transformation of the underlying conflict would also be good but is not always achieved in practice), such a settlement needs the buy in of the parties particularly where the terms are dependent on future performance. This is something that a court judgment or arbitral award can never achieve where inevitably there will be a “winner” and a “loser”.
- Apply the appropriate degree of firmness and leverage, especially at the settlement phase of the mediation. A good mediator cannot be all sweetness and light and must often walk a tight rope when challenging positions and maintaining rapport.
- Control the process. The mediator must stamp her own authority and signature strength on the procedure from the outset. This means determining at what stage in the mediation to hold plenary sessions (all the parties and their representatives come together to talk through the issues) as opposed to private sessions, in the US referred to as “caucusing”. The mediator also has the responsibility to determine when the mediation

should be discontinued. Here we see the distinguishing feature of mediation from direct negotiations between the parties which is the freest and least structured dispute resolution mechanism and yet the most likely to deteriorate into stalemate or protracted litigation.

Advantages of mediation

We have seen how the introduction of a mediator can bring a new dynamism into negotiations and get the parties back on track towards a settlement of their issues. Here we examine the advantages of the process which set it above the conventional dispute resolution mechanisms of arbitration and litigation.

First, speed. In most commercial negotiations this is a crucial factor. Consider an insolvency procedure where value lies in the insolvent undertaking as a going concern. Provided there is buy in to the mediation from the parties (this should certainly not be always assumed) then it can be arranged within weeks if not days and at a convenient venue. In a complex insolvency procedure and provided the parties are competently advised then settlement at least in principle can be achieved within 1-2 days.

Secondly, the possibility of creative solutions. The remedies available from the arbitrator or court are very limited in scope. In a mediation all options are open. Indeed matters can be regulated for the mutual benefit of the parties which have nothing to do with the original dispute.

Thirdly, cost. The current going rate for a mediator in a complex commercial matter is in the region of GBP 5,000 per day and there will also be some reading time to factor in. The parties will typically have to bear their own legal costs. In a complex matter with preparation and attendance allow a week's time for a partner and an associate. This is all however a drop in the ocean compared with arbitration or legal proceedings which run their full course and costs typically approaching or even exceeding seven figure sums. This is apart from the huge amount of management time lost for the parties and the unquantifiable loss of opportunity.

Fourthly, outcome. In the experience of the authors the difficult thing is getting the parties to agree to mediation. Once embarked upon there is a statistically high probability of settlement in commercial matters and usually in excess of 80%. Even in those cases where settlement is not

achieved it is often possible to narrow the issues so that the parties only require a small part of the issues between them to be adjudicated on. Even here there are creative possibilities, e.g. joint instruction of a mutually acceptable expert on an issue whose decision will then be binding.

The defective company voluntary arrangement - an example from real life

So how does this all work out in practice? A case study from a mediation in which one of the authors was involved can illustrate the points and we keep things simple for the moment by dealing with a purely domestic dispute. The facts are disguised somewhat to protect confidentiality.

The parties included a quoted company and substantial manufacturer. In the course of construction of very large warehouse premises for the manufacturer as employer the main contractor had entered into an administration procedure under Part II of the Insolvency Act 1986 and subsequently a company voluntary arrangement. In France and Germany the nearest equivalent would be a “conciliation” or “Insolvenzplan”. The arrangement had not been happily drafted and next to the manufacturer there were two further companies also quoted on the Stock Exchange asserting claims to the same pot of money held by the supervisors of the company voluntary arrangement. The supervisors were one of the big four accounting firms. There was also a fifth player in the form of unsecured creditors represented by the creditors’ committee.

Because of the defective drafting of the voluntary arrangement, the supervisors had already applied to court to determine what it meant so that all five parties were facing an estimated five day hearing in court. Even a positive outcome of the hearing in favour of any one party would still leave 80% of the remaining issues unresolved. Years of continuing dispute lay ahead. It was obvious too that the pot of money in the hands of the supervisors, the “cake” available to the parties to divide and share, was reducing in size by the minute.

Surprisingly the biggest obstacle to mediation was persuading the parties and their respective legal departments that they should mediate. The current proceedings dealing with the construction of the voluntary arrangement were complex and resolution of other outstanding issues was already taking up a lot of management time. Hence, the potential for mediation seemed obvious.

For the manufacturer a risk reward analysis carried out indicated that the costs of mediation would be a small fraction of the overall costs of continuing the dispute and importantly mediation offered a 75% prospect of resolving all issues between the parties.

It was possible to arrange a formal mediation within a matter of weeks, and after 3 days settlement was reached on all issues save one which was resolved some weeks later. A note of caution, however. For all parties and none more so than the mediator(s), mediation is not a soft option. It is extremely hard work requiring focussed and intense preparation and can be enervating and exhausting. As the authors of the negotiating classic “Getting to Yes”⁵ put it:

“A basic fact about negotiation easy to forget in corporate and international transactions is that you are dealing not with abstract representation of the ‘other side’, but with human beings. They have emotions, deeply-held values, and different backgrounds and view points and they are unpredictable – so are you.”

The cross border element

The introduction of a cross border dimension to all this is at first sight alarming. After all, given the definition of conflict above as a “manifestation of differences working against one another” having “ingredients” (defined as the differences between people such as cultural and value differences, interests, beliefs and patterns of behaviour) this manifestation will be dramatically magnified in a cross border insolvency procedure of any size and where typically assets and creditors both secured and unsecured will be located in a number of different jurisdictions with no unified insolvency code.

And yet it is these very circumstances which will make mediation more likely than not. The very uncertainty of enforcement of rights, availability of remedies, and delay make mediation paradoxically more attractive than conventional dispute mechanisms. In other words, the greater the number of issues the greater the incentive on the parties to address their real interests as opposed to bargaining positions and so utilise the medium of facilitated negotiation viz. mediation.

The Directive

The recitals to the Directive contain all manner of laudable reasons as to why mediation in civil and commercial matters should be promoted. The Member States have until May 2011 to implement its provisions. We see no good reason why insolvency practitioners should not adopt the spirit of the Directive straightaway. For the time being we limit ourselves to just two reflections.

First, there could usefully be clarification as to whether the Directive does in fact apply to EU insolvency procedures broadly defined. This is because the decisions to date of the European Court of Justice on the meaning of the expression “civil and commercial matters” do not throw any light on the status of insolvency procedures⁶. The leading authority in the UK is *In Re State of Norway’s Application*⁷ but that again does not decide the issue.

Here it will be recalled that both the Civil Jurisdiction and Judgments Convention and which is in substance re-enacted in EC Regulation 44/2201 on jurisdiction and enforcement of judgments in *civil and commercial matters* specifically exclude from their provisions “bankruptcy, proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings”. The exclusion for bankruptcy did have the advantage that the European Court of Justice in its case law⁸ could fully consider the interpretation of the exclusion but left untouched the question whether bankruptcy was a civil or commercial matter.

It is some consolation that the informal view of the Justice and Home Affairs Department of the Commission is that insolvency procedures do fall within the meaning of the expression “civil or commercial matters”. We share this view. Insolvency procedures solve a common pool problem confronted by the creditors of a distressed debtor by “collectivizing” private enforcement actions.

The second reflection concerns the protectionist legislation of certain jurisdictions in the European Community on giving legal advice. The Directive defines mediator as:

“Any third person who is asked to conduct a mediation in an effective, impartial and competent way, regardless of the denomination or profession of that third person in the Member State concerned and of the way in which the third person has been appointed or requested to conduct the mediation.”

A potential stumbling block in any cross border matter involving Germany would be an infringement of the new Legal Services Act (Rechtsdienstleistungsgesetz) and whether the activities of a mediator who was not qualified as a Rechtsanwalt would infringe the provisions of this legislation. It stipulates that mediation does not constitute a legal service unless the mediator makes proposals on how to resolve the legal issues involved. In the latter case, only a Rechtsanwalt can act as mediator. Hence, the great majority of mediators in the UK who are qualified as solicitors are affected by this legislation because they would not qualify as a Rechtsanwalt. Similar comments would apply to mediators who have qualified as such from other jurisdictions.

We do not consider here comparable regulations or statutes of other Member States which protect the competency status of lawyer and the right to offer legal services. Given the strong steer by the Directive that domestic enactment by the Member States of the Directive should afford full protection and recognition of the “mediator” as defined in the Directive it would indeed be unfortunate if this were overlooked.

The future

Mediation in cross border matters is still in its infancy. Largely for the social and economic reasons advanced in the preamble to the Directive we believe that it will become increasingly the resort of choice of the insolvency practitioner dealing with the disputes which underlie and are systemic to any cross border insolvency procedure. It seems fitting to close with a quotation from the distinguished authors⁹ of International Mediation which expresses the argument perfectly in the context of a business failure:

“There are often a number of reasons for failure shared between the respective parties to a project. In a formal legal process the unravelling of causation and liability can become protracted, and unhelpfully ‘forced’. Any remedy is likely to be therefore a blunt instrument of resolution. However, in a mediation context there is greater fluidity in the process to enable the parties to design an outcome taking account of the technical and commercial failures, successes and proportional contributions of all the parties, rather than being purely focused on the legal effect of failure, which is entirely blame

orientated and usually black-and-white in judgement and restrictive principle. The mediation process and remedy is capable of creating a more equitable, commercially ‘fair’ outcome. Preparation for the process should therefore factor in how best to address ‘proportionality’ of contributions and set them in a broader context if appropriate.”

Those with ears to hear, let them hear.

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¹ Centre for Effective Dispute Resolution (<http://www.cedr.com>).

² Crawley, J., (1995), *Constructive Conflict Management: Managing to Make a Difference*, London: Nicholas Brearley Publishing, pp. 10 and 11.

³ De Bono, E., (1985), *Conflicts: A Better Way to Resolve Them*, London: Penguin Books Limited.

⁴ For a historical philosophical account of conflict see Strasser, J., and Randolph, P., (2004), *Mediation: A Psychological Insight into Conflict Resolution*, Trowbridge: Continuum Press, pp. 3-22. For guidance on turning conflict into an opportunity for choice and change the authors recommend Crum, Thomas F., (1988), *The Magic of Conflict: Turning a Life of Work into a Work of Art*, New York: Touchstone. For a treatise on conflict management in civil and commercial matters see Duve, Ch., Eidenmüller, H., and Hacke, A., (2003), *Mediation in der Wirtschaft: Wege zum professionellen Konfliktmanagement*, Frankfurt and Cologne: Otto Schmidt Verlag Germany.

⁵ Fisher, R., Ury, W., and Patton, B., (2003), *Getting to Yes: Negotiating Agreement without Giving In*, Chatham: Random House Business Books.

⁶ See Layton, A., and Mercer, H., (2004), *European Civil Practice* vol. 1, 2nd edition, Sweet & Maxwell at p.336. The first decision is *LTU Lufttransport Unternehmen GmbH v Eurocontrol* [1976] ECR 1541. For the further case law see paras. 12.011 *et seq.*, *op.cit.*

⁷ [1990] 1 AC 723 (HL).

⁸ The locus classicus is *Gourdain v Nadler* [1979] ECR 733 and see further the case citation in Layton & Mercer *op. cit* paras. 12.011 *et seq.*

⁹ Carroll, E., and Mackie, K., (2006), *International Mediation: The Art of Business Diplomacy*, 2nd edition, London: Tottel publishing.